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VIETNAM

October 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR VIETNAM

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Vietnam, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on June 11, 2014, with the officials of Vietnam on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 15, 2014.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the staff report.
- A **Statement by the Executive Director** for Vietnam.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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July 15, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

KEY ISSUES

Context. Economic performance has improved over the last year. The recovery is taking hold, although domestic activity remains weak, in part constrained by weak banks and inefficient state-owned enterprises (SOEs). Inflation has declined, the current account remains in large surplus, and international reserves have increased. The authorities place a priority on preserving macroeconomic stability, tackling banking sector vulnerabilities, and reforming SOEs, though implementation has been gradual in some key areas.

Outlook and risks. Growth is projected to recover gradually over the coming years, with the current account returning to a deficit and inflation contained. On current policies, public debt is projected to reach 60 percent of GDP. Risks include weaker trading partner growth, geopolitical tensions, slow structural reforms, and delayed fiscal consolidation. Early conclusion to key trade negotiations would be growth-positive.

Fiscal policy. Deficits have been sizable and rising public debt requires attention. A medium-term growth-friendly consolidation is recommended, based on enhancing revenue and rationalizing unproductive expenditures while preserving crucial social and capital spending. This would ensure public debt sustainability with space to address contingent liabilities from banking sector and SOE restructuring.

Monetary and exchange rate policy. The current monetary policy stance is appropriate. Greater exchange rate flexibility would help buffer external shocks, facilitate improved reserve adequacy, and help lay the groundwork for shifting toward using inflation as a nominal anchor over the medium term.

Banking sector reform. Several policy measures have been taken recently, but the overall gradual approach will likely continue constraining credit growth and keep the system susceptible to shocks and significant asset deterioration. A more expeditious recognition of nonperforming loans, bank restructuring and orderly resolution would support robust credit creation and macro-financial stability.

State-owned enterprise reform. Progress is being made. Implementing restructuring plans and accelerating equitization would help ensure more efficient resource allocation, strengthen banks, and deliver higher future growth. Reform should also focus on strengthening corporate governance and ensuring a level playing field.

Approved By
Markus Rodlauer and Ranil Salgado

Discussions took place during May 28–June 11, 2014. The staff team comprised J. Nelmes (Head), A. Ahuja, G. Bannister (all APD), E. Liu (FAD), D. Grigorian (MCM), and S. Kalra (Resident Representative). Ms. Nguyen and Mr. Ghaffour (OED) joined the concluding meetings. Ms. Sirihorachai and Ms. Tu assisted in this report's preparation.

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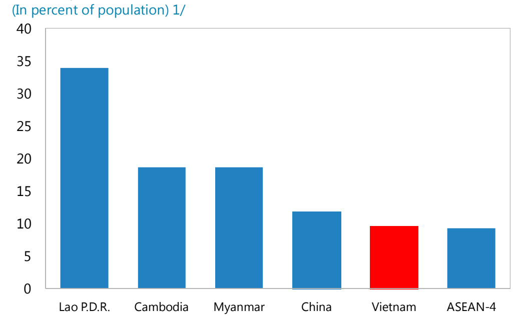
CONTEXT

1. **Economic performance has improved over the last year, with the challenge now to mitigate vulnerabilities.** Growth is improving gradually, underpinned by robust exports and foreign direct investment (FDI) while domestic activity remains subdued. Inflation has declined to mid-single digits. The external current account remains in large surplus and international reserves have increased. Significant gains in poverty reduction made in recent decades have been preserved (Box 1). Notwithstanding, growth is below its previous trend, and the economy is exposed to spillovers from downside external shocks. Domestic vulnerabilities also exist, including banking sector weakness and inefficient state-owned enterprises (SOEs), both of which are restraining activity. Public and publicly guaranteed debt has risen to a level that requires attention.

Poverty Headcount
(In percent of population) 1/



Sources: World Bank Development Indicators and Vietnamese authorities.
1/ Headcount at US$1.25 per day, for Vietnam official rate (2012).

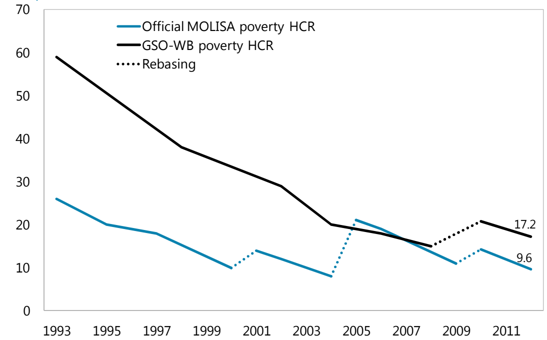
2. **The authorities place a high priority on securing macroeconomic stability and strengthening fundamentals.** The government's socio-economic development plan (through 2020) targets average growth of 6½–7 percent with single-digit inflation. It prioritizes macroeconomic stability, tackling banking sector vulnerabilities, and reforming SOEs and public investment. Accelerating and deepening the agenda, creating fiscal space to address potential contingent liabilities from reforms while safeguarding critical social and investment spending, would mitigate risks and facilitate achievement of the development goals. Moving gradually toward using inflation as a nominal anchor with greater exchange rate flexibility would provide a monetary policy framework more conducive to maintaining stability and buffering external shocks.

3. **Policies are broadly in line with past Fund advice, although along a more cautious timeline.** The authorities have made progress on many priorities outlined in the last Article IV consultation. Banking system reforms have been initiated, including individual bank restructuring plans, and a scheme to transfer nonperforming loans (NPLs) to an asset management company. However, full implementation of prudential regulations to bring asset classification and provisioning closer to international standards has been delayed, with concurrent slow progress in NPL resolution and bank recapitalization. SOE restructuring has moved forward with plans for equitization, enhanced transparency, and improvements in the legal framework, although implementation has been slow. Fiscal consolidation has not materialized.

Box 1. Vietnam: Poverty Reduction, Inclusive Growth, and Remaining Challenges[1]

Vietnam has made remarkable progress improving living conditions and reducing poverty. It employs two approaches to measure poverty. The first uses a "basic needs" poverty line adjusted for inflation, adopted in the early 1990s with assistance from the World Bank and updated in 2010. By this measure, the national poverty rate declined from 58 percent in 1993 to around 17 percent in 2012. A second approach, initially based on rice equivalents and revised in 2005 to use basic needs, but adjusted for inflation only every five years, shows poverty fell from around 28 percent in the early 1990s to around 9½ percent by 2012—the official rate.

Poverty Reduction
(In percent)



Source: World Bank.

While growth has been pro-poor under both measures, success has brought some additional challenges. Inequality has risen slightly compared to the 1990s, spurred by changing patterns of employment away from agriculture, and from low-skill to higher-skill work. The Gini coefficient was 0.39 in 2012, comparable to that of other middle-income countries in the region. The remaining poor depend heavily on subsistence agriculture and live in remote upland rural regions, isolated from main markets. Poverty has also taken an increasingly ethnic dimension, as the income gap between ethnic minorities and the Kinh majority has grown. Many incomes remain close to the poverty level, and are susceptible to falling back into poverty as a result of macroeconomic shocks. The quality of, and access to, public services and social assistance vary between rich and poor households.

Based on these findings and cross-country experience, a number of policies could reinforce poverty reduction and support inclusive growth:

- Ensuring macroeconomic stability and reducing vulnerabilities, and structural reforms to support robust, sustainable growth.
- Supporting productivity growth in rural areas through improved connectivity, strengthening skills, improving the investment climate, expanding access to basic services, better targeting agricultural and social support, and fostering the occupational and geographic mobility of labor. Improving access of the poor to higher-quality education and health services, particularly in rural areas and by minority ethnic groups, would help address inequality of opportunities.

New Poverty Estimates for 2012 by Urban and Rural Areas

	WB-GSO Poverty Estimates		Official Poverty Estimates	Population Shares (Percent)
	Poverty Rate (Percent)	Contribution (Percent)	Poverty Rate (Percent)	
National	17.2	100	9.6	100
Urban	5.4	10	...	30
Rural	22.1	90	...	70

Sources: World Bank and Ministry of Labour, Invalids and Social Affairs.

- As the economy is restructured, social spending and social assistance should be better targeted to take into account regional differences in the cost of living and basic services.
- Improving the system for monitoring and publishing data on poverty to deliver reliable and accurate information to policymakers and the public.

[1] "*Well Begun, Not Yet Done: Vietnam's Remarkable Progress on Poverty Reduction and the Emerging Challenges*," World Bank in Vietnam, Hanoi (2012).

MACROECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

4. **Growth is improving gradually and inflation has declined.** Real GDP expanded by about 5½ percent in 2013, underpinned by robust exports and FDI. Domestic activity remained subdued despite supportive countercyclical policies, reflecting in part headwinds from a weakened banking sector and slow progress in SOE reform. A negative output gap is estimated to have emerged (Box 2), and headline and core inflation have fallen, to 5 and 3½ percent, respectively, in mid-2014. The unemployment rate remains low, but underemployment exists, particularly in rural areas, and economy-wide wage growth was flat.

5. **Fiscal policy eased.** The 2013 fiscal deficit is estimated at 5½ percent of GDP (GFS 2001), compared to 4¼ percent implied by the budget.[1] Tax revenues fell short of the plan by about 1½ percentage points of GDP, mainly due to sluggish economic growth, tariff reductions, and new exemptions, while nontax revenues significantly outperformed in part due to increased dividend receipts from SOEs. Current spending was close to budget while capital expenditure was higher than planned.

6. **Monetary conditions remain accommodative.** With inflation on a downward trajectory and growth below potential, the State Bank of Vietnam (SBV) reduced policy rates by 50 basis points in early 2014. Overnight interbank rates have been well below policy rates due to ample liquidity and the domestic government bond benchmark yield curve has declined. Sovereign spreads narrowed by about 100 basis points early this year, but gave back some of those gains following regional geopolitical tensions in May. The official exchange rate was depreciated by one percent in mid-June.

7. **The current account remains in significant surplus and international reserves increased.** Robust growth in exports, tourism, and private remittances led to a current account surplus of 5½ percent of GDP in 2013. The financial account saw large net inflows of FDI and loans. However, in mid-2013 these were balanced by large capital outflows associated with the unwinding of gold deposits at commercial banks and following the announcement of U.S. Federal Reserve tapering. As a result, the overall balance of payments saw only a small surplus in 2013. With continued robust exports, gross international reserves rose in early 2014, to above US$36 billion, 2½ months of prospective imports of goods and services.

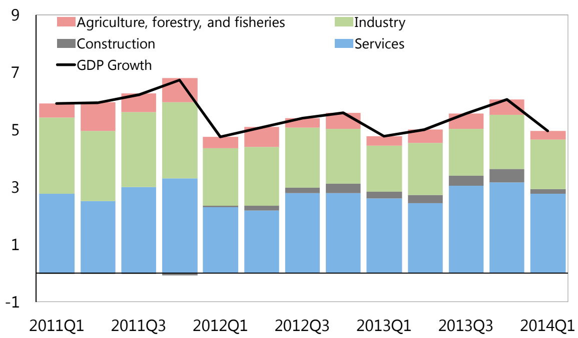
8. **Bank credit to the private sector has been sluggish and profitability has weakened.** Despite accommodative monetary conditions and strong deposit growth, private sector credit growth was 2¼ percent (s.a., ytd) in March 2014, reflecting weak demand and ongoing adjustment due to weakened balance sheets. The system-wide loan-to-deposit ratio has fallen to below

[1] GFS 2001 presentation is different from the authorities' presentation, mainly reflecting the inclusion of off-budget capital expenditure and the exclusion of principal repayments above the line.

Figure 1. The economy is gradually recovering

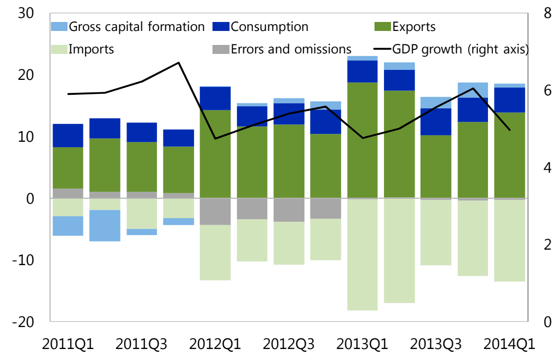
The economy is gradually improving, led by industrial activity…

Contribution to GDP Growth by Economic Activities (2010 prices)
(In percent)



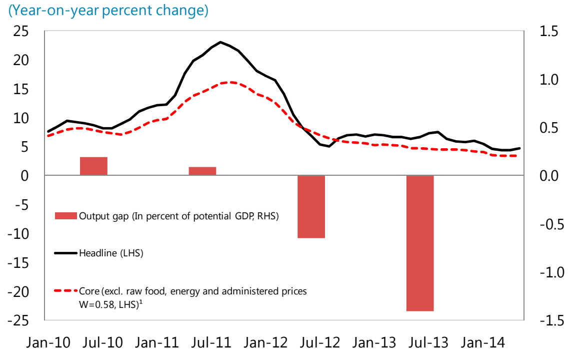
…reflecting healthy exports, while domestic demand remains subdued.

Contribution to GDP Growth by expenditure (2010 prices)
(In percentage points)



Headline and core inflation are on downward trajectories.

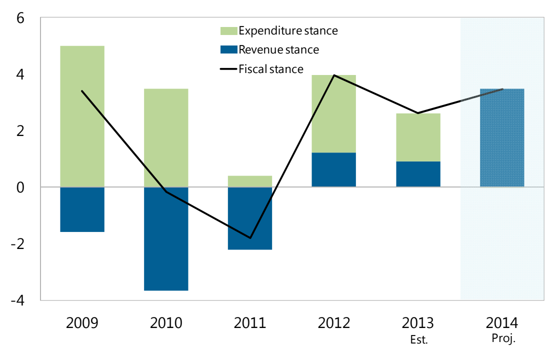
Inflation and Output Gap
(Year-on-year percent change)



[1] W=2009 Weight

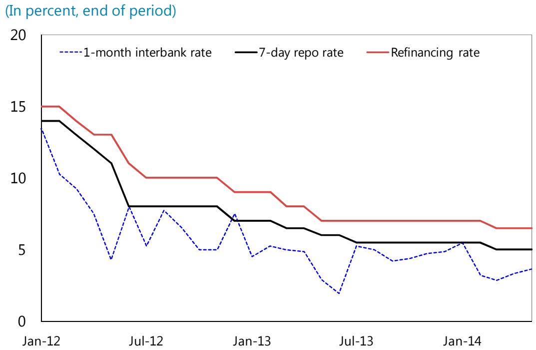
Fiscal policy has been expansionary.

Revenue and Expenditure Stance
(In percent of GDP)



Monetary policy remains supportive…

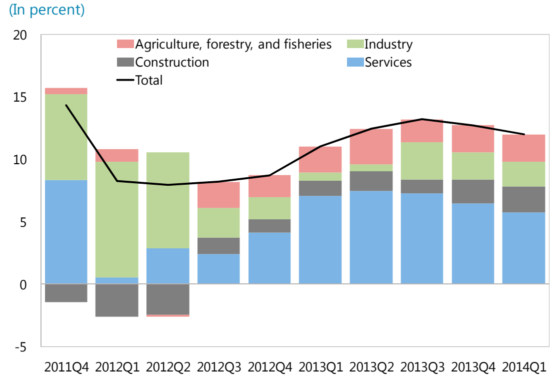
Interest Rates 1/
(In percent, end of period)



1/ 1-month interbank rate is from Bloomberg.

… and credit growth has been relatively subdued.

Contribution to Credit Growth
(In percent)



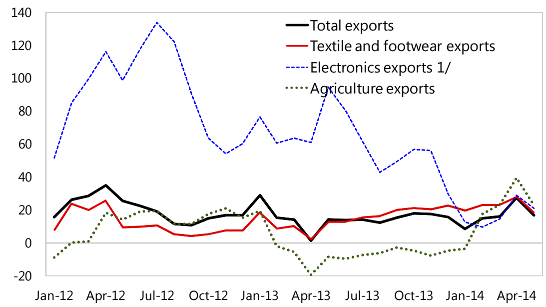
Sources: Vietnamese authorities; Bloomberg LP; and IMF staff estimates.

Figure 2. The external position recovered strongly after capital outflows mid-2013

Exports continue to perform well....

Exports

(3mma, year-on-year percent change)

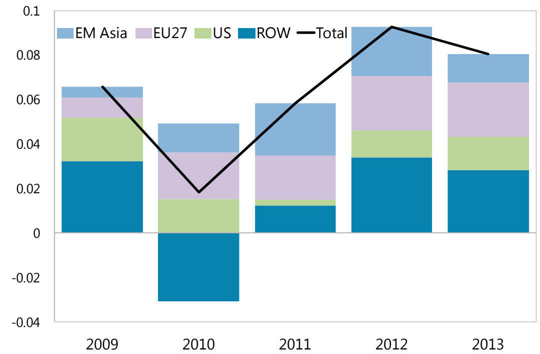


1/ Include electronic goods and PC, electronic wire and cable, and telephone (all kinds and parts).

...sustaining global market share gains.

Change in Export Market Share From Previous Year

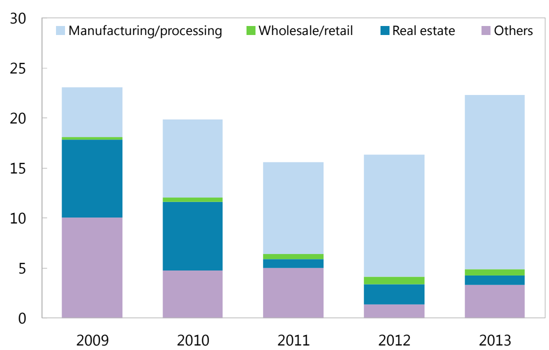
(In percentage points)



Export activity is supported by robust FDI, increasingly in manufacturing...

FDI Commitments

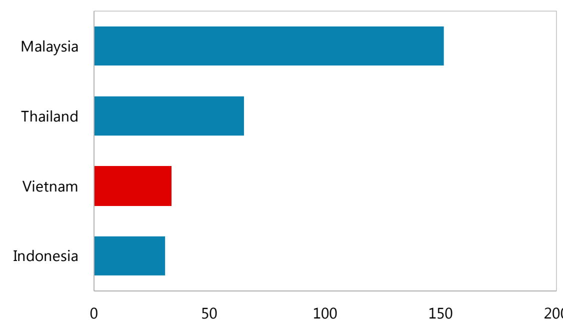
(In billions of USD)



...and wages remain competitive internationally.

Nominal Wages Relative to China, Manufacturing Sector 1/

(In percent)

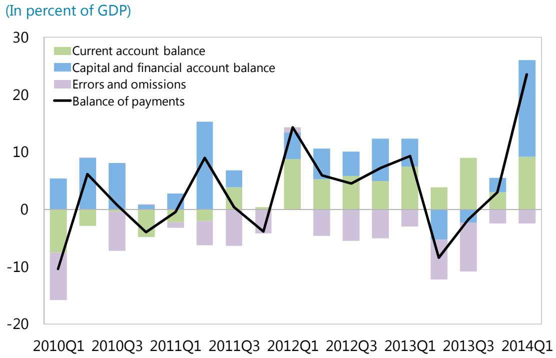


1/ China and Vietnam as of September 2013, and all others at end-2013

The balance of payments recovered strongly after capital outflows associated with mid-2013 tapering expectations...

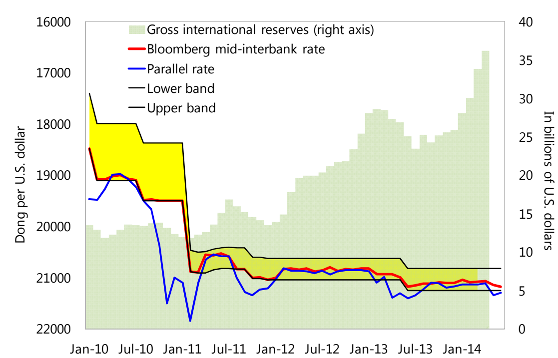
Balance of Payments

(In percent of GDP)



...raising the level of official international reserves.

Exchange Rates 1/



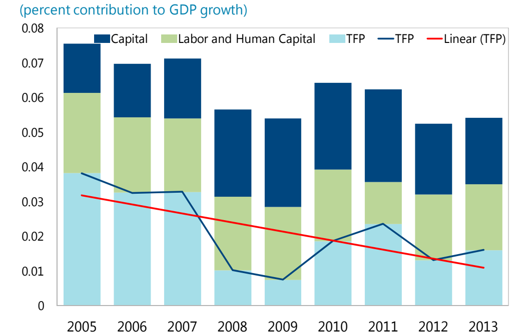
Sources: Vietnamese authorities; Bloomberg LP; IMF, DOTS; IMF, WEO; and IMF staff estimates.

Box 2. Vietnam: Productivity, Technical Efficiency, and Potential GDP

Total factor productivity (TFP) calculations using data from the national accounts show that the contribution of TFP to growth in Vietnam has declined in the last decade. Capital's contribution increased, but by less than TFPs' decline, and consequently growth slowed.

Real GDP growth and TFP -National Accounts

(percent contribution to GDP growth)



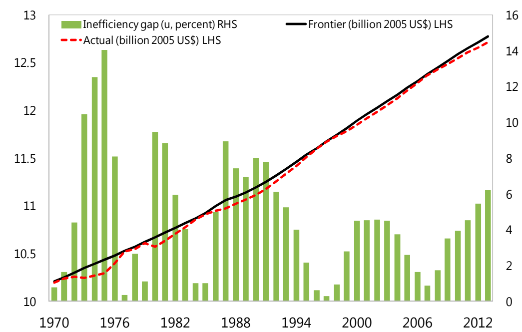
Sources: Vietnamese authorities; and IMF staff estimates

Production function frontier analysis confirms this finding.[1] A production function frontier represents the optimal output that can be achieved given a set of inputs. The basic stochastic production frontier can be characterized in the Cobb-Douglas form with a "composed error term" as follows:

$$\text{Ln}\, y_t = \beta_0 + \textstyle\sum_n \beta_n ln x_{nt} + v_t - u_t \;,$$

where y_t is real GDP, x_{nt} are capital and labor inputs, and v_t is a traditional error component. The last term u_t is a technical inefficiency component of the error term restricted to be non-negative ($u_t \geq 0$). Intuitively, it represents the gap between the frontier, which is the optimal output, and the actual output achieved, which is usually below the frontier given productive inefficiencies in the economy.

Potential GDP Frontier vs. Actual

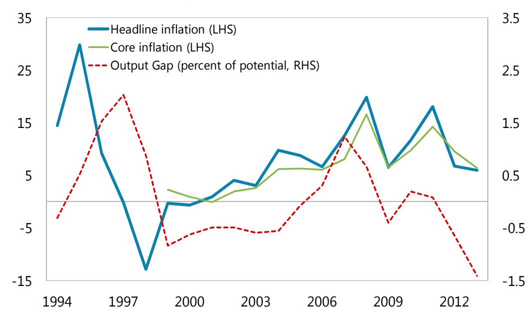


Source: IMF staff estimates

The stochastic production function is estimated for Vietnam using maximum likelihood estimation and data from the Penn World Tables from 1970 to 2013. The estimated inefficiency parameter u_t then provides an index of how close or far the economy is from its most efficient frontier in each time period. The inefficiency gap varies over time but is shown to increase in the early 1990s, early 2000s and again from 2009 forward. This is consistent with the previous findings of a decline in the contribution of TFP to growth from 2009 forward.

Output Gap and Inflation

(Year-on-year percent change)



Sources: Vietnamese authorities; and IMF staff estimates.

Potential output and the output gap can be calculated using this estimated production function. Following standard procedure, trend series for labor, capital and estimated inefficiency (*u*) are calculated using an HP filter. Based on this, potential growth is currently around 6 percent (below the 7 percent average of the last decade), and would remain close to that rate in coming years, assuming inputs, TFP, and inefficiency remain around current levels, consistent with the gradual reform scenario in staff's baseline projection. A negative output gap opened after the global financial crisis, and widened to around 1½ percent of potential GDP in 2013. This output gap tracks well with recent inflation trends.

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[1] For a discussion of stochastic frontier analysis see Subal C. Kumbhakar and C. A. Knox Lovell, *Stochastic Frontier Analysis***,** Cambridge University Press (2000).

90 percent from a peak of around 105 percent in 2011, helped partly by sales of NPLs to the Vietnam Asset Management Company (VAMC). The official NPL ratio rose to 4.2 percent and capital adequacy is reported above the 9 percent regulatory minimum, but stricter loan classification and provisioning, and adjustments to account for multiple gearing and connected lending would likely cause both to show a significantly weaker situation. NPLs and sluggish credit growth resulted in weaker profitability, with the system-wide ROA and ROE in 2013 at 0.5 and 5.6 percent, respectively. Prices of real estate, a significant source of banks' loan collateral, have yet to turn around after falling by about 50 percent from their peak.

9. **Growth is projected to continue its gradual recovery with subdued inflation.** Staff's baseline scenario assumes the authorities will maintain an expansionary policy stance to offset headwinds from slow banking and SOE reform implementation. For 2014, real GDP growth is projected at 5½ percent, inflation around 5¼ percent, the current account in surplus, and reserves around 2½ months of prospective goods and services imports. Over the medium term, growth is projected around 6 percent, reflecting a cyclical recovery of the domestic economy, with inflation remaining in single digits. A rebound in imports would return the current account to a deficit. The current fiscal stance would result in the accumulation of public sector debt to around 60 percent of GDP, slightly below the authorities' legal limit of 65 percent.

10. **Under this scenario, domestic risks are tilted to the downside.** Slow progress in banking reform raises the economy's vulnerability to adverse shocks and heightened distress, the realization of which could result in negative macro-financial feedback, significantly undermining growth and adding to public-sector liabilities. Delays in fiscal consolidation would reduce fiscal space that may ultimately be required for banking and SOE reforms, and could pressure interest rates, crowd out growth-enhancing spending, erode public confidence, and ultimately undermine debt sustainability.

Vietnam: Risk Assessment Matrix 1/

Risk	Up/Down-Side	Likelihood	Impact	Transmission Channels	Policy Response
Banking distress becomes acute	↓	**L**	**H**	Adverse macro-financial feedback loop	Activate crisis management plan, ensure emergency liquidity while maintaining monetary control, orderly bank resolution and recapitalization, strengthen safety nets.
Fiscal consolidation delayed	↓	**M**	**M**	Persistently higher interest rates; business confidence undermined	Broaden revenue base, reduce exemptions, strengthen administration, introduce a property tax, curtail non-essential spending.
Surges in global financial market volatility	↓	**H**	**L**	Capital outflows pressure exchange rate and reserves	Greater exchange rate flexibility and stand ready to raise interest rates. Accelerate fiscal consolidation, and structural reforms to support confidence and FDI.
Protracted period of slower growth in advanced and emerging economies, growth slowdown in China (medium-term)	↓	**H/M**	**M**	Weaker export growth and remittances	Adopt monetary policy framework with more exchange rate flexibility. Accelerate financial sector and SOE reforms to improve productivity, FDI, and domestic activity.
Disruptions triggered by geopolitical incidents in East Asia	↓	**H**	**M**	Capital flight, weaker FDI inflows, lower tourism, export and import growth	Stand ready to raise interest rates, allow exchange rate flexibility. Accelerate structural reforms to support confidence and investment.
Earlier-than-expected implementation of TPP or FTAs	↑	**L**	**M**	Stronger exports and investment; productivity improvement	Accelerate SOE and market reforms, and adopt monetary policy framework with more exchange rate flexibility.

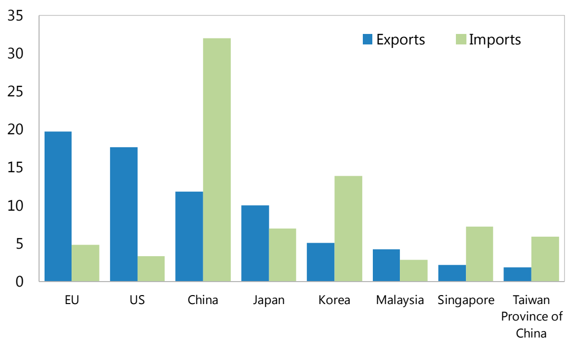
1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

11. The economy is also vulnerable to spillovers from external shocks. In the short-term, surges in global financial market volatility, higher global interest rates, or protracted regional geopolitical tensions could undermine confidence, and reduce international reserves absent greater exchange rate flexibility. In the medium-term, a high degree of openness and reliance on FDI make the economy vulnerable to slower growth in major trading partners. In particular, China is an important trade partner, main source of imports into the electronics and garments supply chain, and source of FDI and tourism (Figure 3). Early agreement on Trans Pacific Partnership (TPP) negotiations and Free Trade Agreements (FTAs) with the European Union and Korea are upside opportunities that would secure access to main export markets and spur market-based reforms.

Figure 3. Vietnam: Regional Linkages

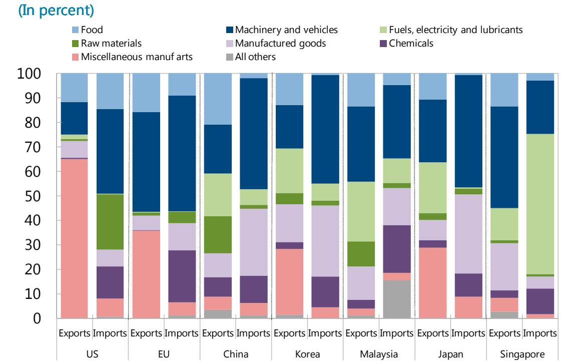
China is an important trading partner,...

Share of Exports and Imports, 2013
(In percent of total Vietnam's exports/imports)



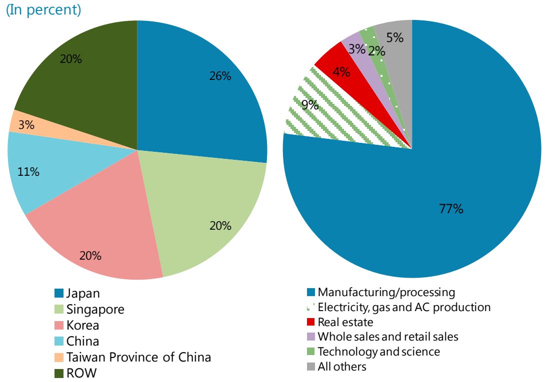
...a key source of capital and manufactured goods imports, and an important food and fuel export destination.

Composition of Total Trade, 2012
(In percent)



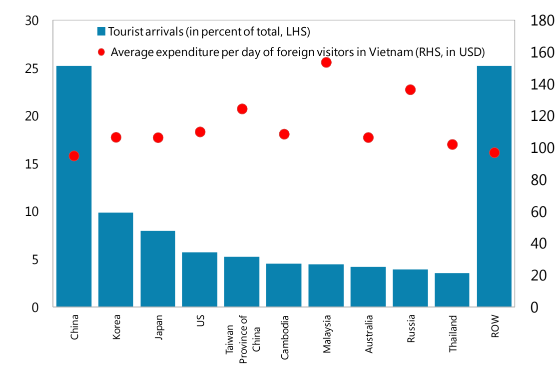
China also accounts for a moderate share of FDI commitments,...

FDI Commitments, 2013
(In percent)



...and a sizable share of tourism receipts.

Tourism



Sources: Vietnamese authorities; UN Comtrade; IMF, DOTS; and IMF staff estimates.

12. The authorities broadly concurred with the near-term macroeconomic outlook. To mitigate external risks they have reassured investors following recent geopolitical events, and reinforced the importance of structural reforms, trade diversification, and on-shoring of supply chains through TPP and other FTAs. They noted that the current account surplus, capital flows management, and the relatively small holdings of domestic assets by nonresidents limited the impact of global financial volatility on domestic markets. On domestic risks, they emphasized work was underway on bank and SOE restructuring, with progress in line with their plans, and they viewed the risk of systemic distress as small. They considered the level of public debt as manageable, but recognized the risks of a further increase, and were looking to tighten fiscal policy gradually going forward.

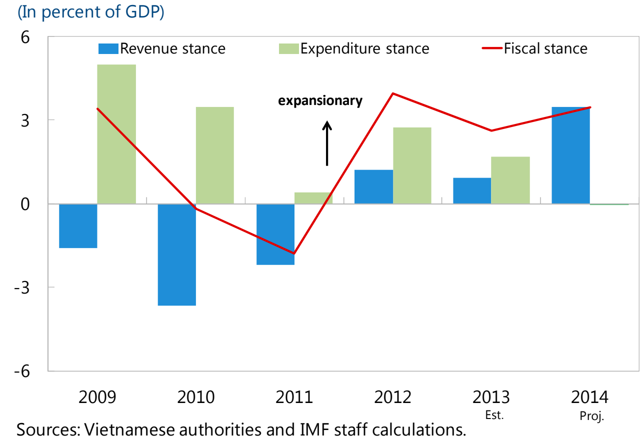
POLICY DISCUSSIONS

Discussions focused on the near-term macroeconomic stance to entrench stability; measures to underpin a growth-friendly fiscal consolidation and address rising public debt; strengthening the monetary policy framework and moving toward greater exchange rate flexibility; broadening the banking sector reform agenda; and advancing SOE reforms.

A. Fiscal Policy

13. As growth has slowed in recent years, an expansionary countercyclical policy has been adopted. Tax and tariff reductions and exemptions have contributed to a downward trend in revenues as a share of GDP, in contrast to regional experience, resulting in an expansionary revenue stance in cyclically adjusted terms. The expenditure stance has also been stimulative. For 2014, the deficit is projected to rise to around 6½ percent of GDP (GFS 2001), with lower revenue (reflecting a cut in the corporate income tax rate from 25 to 22 percent, continued tariff reductions, exemptions, and subdued growth) more than offsetting expenditure restraint, including capital outlays and a freeze on the size of the civil service and wages.

Revenue and Expenditure Stance
(In percent of GDP)



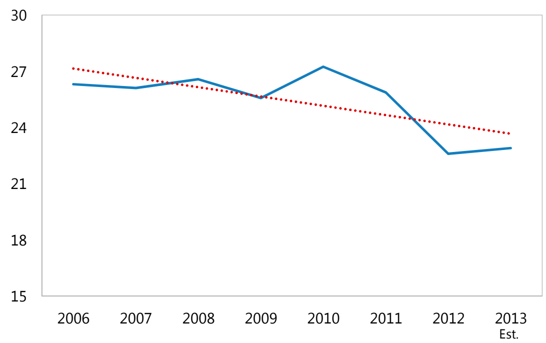
Sources: Vietnamese authorities and IMF staff calculations.

14. Efforts have been made to broaden the revenue base, but buoyancy has declined. Improved administration measures include reducing tax evasion and arrears, disclosing incidents of tax fraud, and streamlining VAT refund procedures while introducing thresholds. Profitable SOEs have been required to pay dividends in 2013–14. Vietnam compares favorably in the region in terms of tax revenue productivity but the base has eroded, reflecting in part exemptions and incentives. At the same time, the VAT rate was halved for certain housing projects and a further corporate income tax rate reduction, to 20 percent in 2016, is planned.

Figure 4. The fiscal position has deteriorated, and public debt is rising

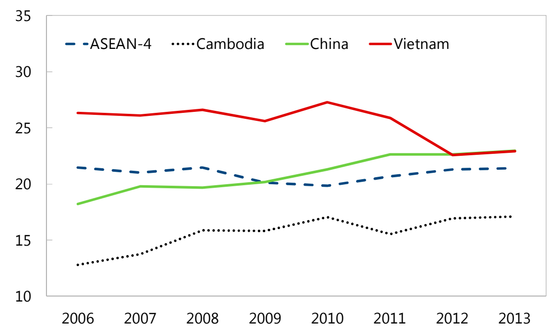
Fiscal revenue has been in decline…

Revenue
(In percent of GDP)



…in contrast to regional trends…

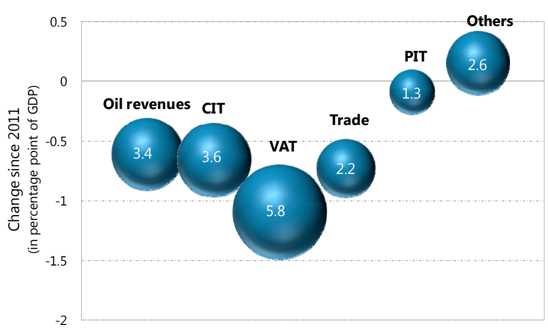
Revenue 1/
(In percent of GDP)



1/ ASEAN-4 includes Indonesia, Malaysia, Philippines, and Thailand.

…with weakness in VAT, trade, CIT, and oil revenues since 2011.

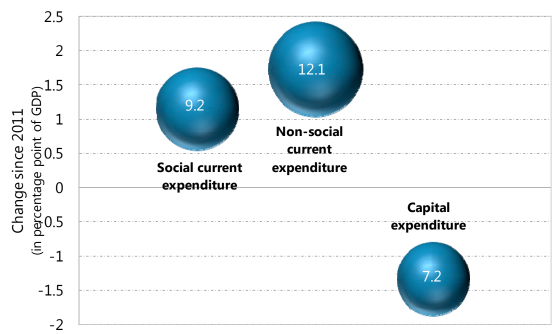
Revenue, 2013 1/
(Change since 2011, and percent of GDP)



1/ Size of the bubble represents the share of GDP.

Meanwhile, capital spending has been restrained since 2011…

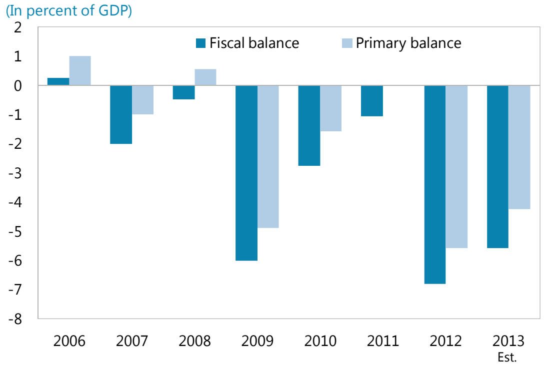
Expenditure, 2013 1/
(Change since 2011, and percent of GDP)



1/ Size of the bubble represents the share of GDP.

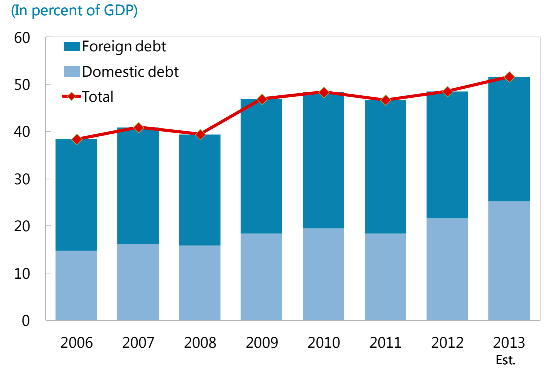
…to limit the deterioration in the fiscal position.

Fiscal Balance
(In percent of GDP)



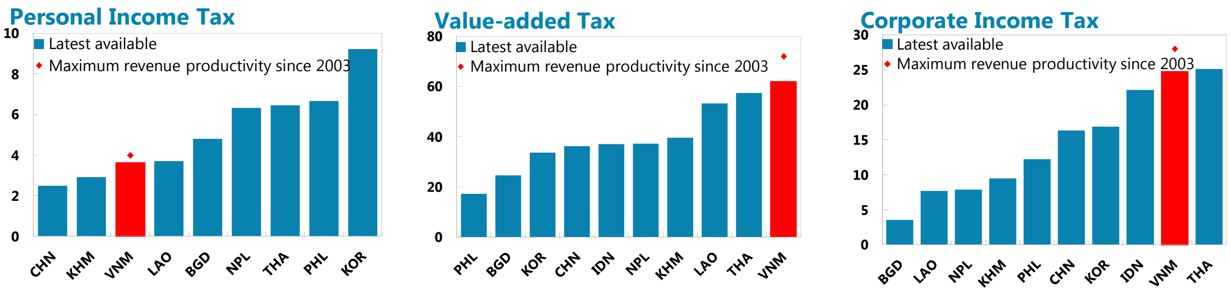
Public debt is rising, with domestic debt accounting for most of the increase.

Public and Publicly Guaranteed Debt
(In percent of GDP)



Sources: Vietnamese authorities; IMF, WEO; and IMF staff estimates.

Tax Revenue Productivity, 2013

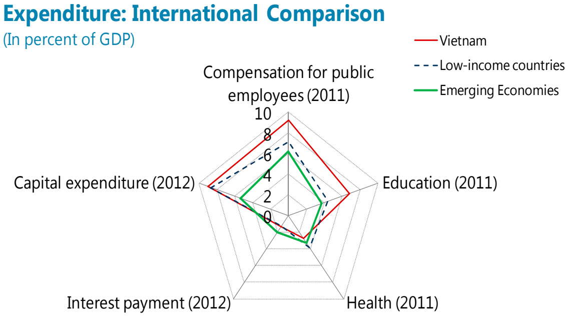


Sources: World Economic Outlook and IMF staff calculations.

Note: Revenue productivity is revenue to GDP ratio divided by tax rate. Earlier data are used if 2013 data are unavailable.

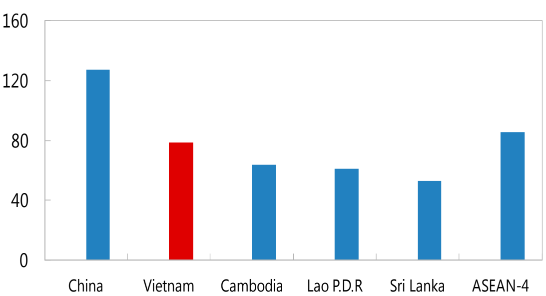
15. **Room exists to adjust the composition of expenditure.** Spending on education is commendably higher than in comparator low-income and emerging-market countries. However, expenditure on public employee compensation is significantly higher as a share of GDP. Capital spending has historically been in line with other low-income countries, but a decline is budgeted this year. Maintaining high-quality investment spending would improve the stock of public capital in a regional comparison.

Expenditure: International Comparison
(In percent of GDP)



Sources: *World Economic Outlook*; World Bank, *World Development Indicators*; IMF staff and authorities estimates.

Public Capital Stock
(In percent of GDP, 2011)

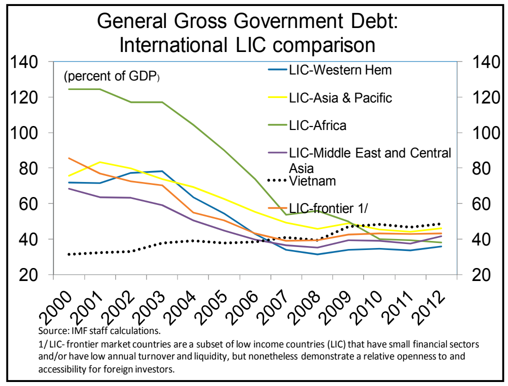


Sources: Center for International Comparisons, OECD, IMF staff.
Note: ASEAN-4 includes Indonesia, Malaysia, Philippines and Thailand.

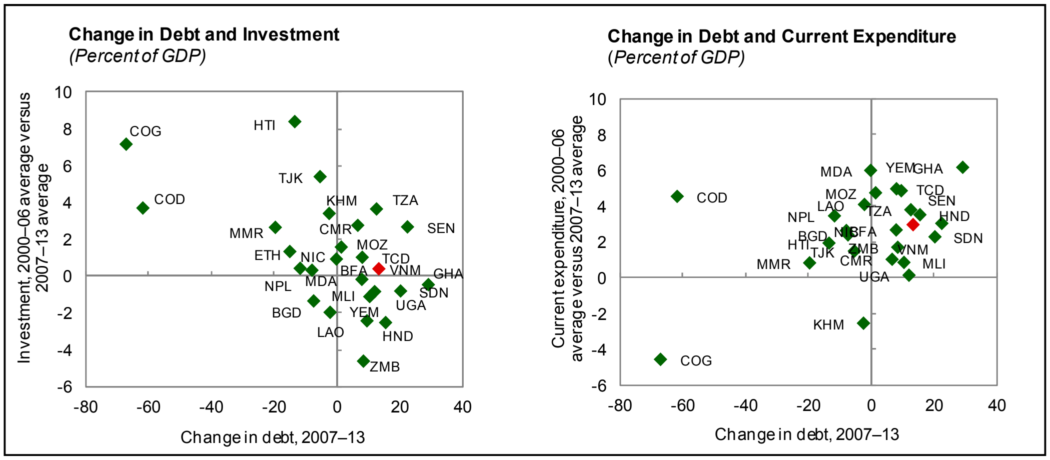
16. **Public debt is projected to increase to around 55 percent of GDP in 2014, substantially higher than just a few years ago, requiring increased attention** (Box 3, and debt sustainability analysis). Maintaining the current policy trajectory would lead to higher debt even with continued expenditure restraint—including on investment, which undermines long-run growth potential—and temporary revenue measures such as SOE dividend payments. The effectiveness of the current expansionary stance is undermined by the economy's structural constraints, it takes up fiscal space raising vulnerability to shocks, and risks crowding out lending to the private sector. Moreover, international experience indicates that public debt could rise substantially were systemic banking sector distress to materialize. SOE restructuring may also ultimately require public funds.

Box 3. Vietnam: What is an Appropriate Medium-Term Public Debt Target?

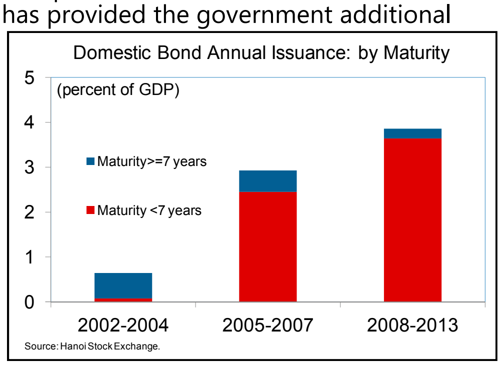
Public debt in Vietnam has increased considerably in recent years. In contrast, other low income economies have generally reduced public debt ratios. Public and publicly-guaranteed debt almost doubled since 2000, and at around 55 percent of GDP in 2014, is higher than average in the region and among low-income economies.



The rise has resulted from an easy fiscal stance, reflecting primary deficits, and recently, an output gap. The rise in debt accompanied higher current expenditure over this period, while capital spending remained broadly unchanged as a share of GDP.



While external concessional loans remain a large share of the debt portfolio, domestic debt has accounted for most of the increase. Domestic bond market development has provided the government additional financing sources, but vulnerabilities are building. The maturity structure has been shortened greatly, with maturities of less than seven years comprising 94 percent of total annual domestic bond issuance in the 2008–13 period. As well, agencies other than the Ministry of Finance are allowed to issue bonds with maturities exceeding one year.



Cross-country experience suggests that Vietnam's public debt is rapidly approaching an unsafe level. Three econometric models are estimated to determine thresholds beyond which debt distress could materialize. Probit and signal models are estimated using cross-country data and the results are applied using data for Vietnam, while a debt intolerance model estimates the relation between public debt and investment ratings for Vietnam.[1] To calculate a safe debt threshold, a buffer for potential contingent liabilities is subtracted from the estimated debt distress thresholds—the value of the buffer is the average debt increase that has materialized in international experiences of systemic banking distress.[2] The results suggest a safe debt level ranging from 40 to 45 percent of GDP for Vietnam.

Debt Threshold

(Percent of GDP)	Probit Approach	Signal Approach	Debt Intolerance Framework
Debt distress threshold	65	69	70
Buffer for contingent liabilities	25	25	25
Safe threshold	40	44	45

[1] For methodologies, see Bannister and Borrot (2013), Jarmuzek and Miao (2013), and IMF (2014), forthcoming.
[2] Claessens and others (2011).

[1] For methodologies, see Bannister and Barrot (2013), Jarmuzek and Miao (2013), and IMF Working Paper (2014), forthcoming.
[2] Claessens and others (2011).

17. Staff recommended a fiscal consolidation that protects social spending and investment and makes space for potential restructuring costs. A growth-friendly consolidation that returns the debt ratio over the medium term closer to 45 percent of GDP, around the level that existed a few years ago, is achievable. The aim would be to support robust inclusive growth and poverty reduction, and mitigate risks. The adjustment would provide space for potential bank and SOE restructuring costs, higher capital spending, and maintaining critical social expenditures.

Fiscal Consolidation Scenario 1/

(In percent of GDP)	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total revenue and grants	20.3	20.9	21.6	22.4	23.0	23.7	24.3	24.9	25.4
Capital expenditure	6.5	6.5	6.6	6.6	6.7	6.8	6.9	6.9	7.0
Non-interest current expenditure	18.9	18.6	18.4	18.1	17.9	17.6	17.4	17.1	16.9
Interest expense	1.5	1.5	1.6	1.6	1.6	1.6	1.4	1.4	1.2
Net lending (+)/borrowing (-)	-6.6	-5.7	-4.9	-4.0	-3.1	-2.3	-1.4	-0.6	0.3
Public and public-guaranteed debt	54.8	56.8	58.2	58.4	57.6	56.0	53.6	50.8	47.3
Real growth impact (in percentage point)	--	-0.1	-0.2	0.0	-0.1	-0.2	-0.2	-0.3	-0.2

Source: IMF staff.
1/ Public guaranteed debt, ODA onlending and valuation change are the same as in the baseline.

18. Reversing the decline in the revenue to GDP ratio is a priority. Staff recommended broadening the tax base by eliminating exemptions, reducing incentives, introducing a property tax, and including pensions under personal income tax. Forgoing the planned reduction in the corporate income tax rate would contribute around ⅓ percentage points of GDP in revenue, and making permanent the requirement for SOEs to pay dividends to the budget would also contribute importantly. Strengthening administration could return revenue productivity to past higher levels and result in significant revenue gains.

19. Staff proposed expenditure reforms along three dimensions: ensuring the sustainability of social spending and targeted measures to address inequality and growth inclusiveness; safeguarding well-targeted capital expenditure to support growth potential; and rationalizing the public wage bill in a sustainable way by replacing the across-the-board wage and hiring freezes with deeper, efficiency-enhancing civil-service reforms.

20. The authorities broadly agreed with staff's baseline fiscal assessment. They aim to broaden the tax base and strengthen administration, but noted a property tax and personal income tax on pensions would be difficult to enact. Consideration is being given to raising excises, while income tax rate reductions are needed to support growth and competitiveness, and should result in higher revenues. Social spending will be protected with priority given to poverty reduction, agriculture and rural areas; the law on public investment has been revised to enhance efficiency and prioritization; and greater use of public-private partnerships is under consideration. The authorities concurred with the objective of containing the public sector wage bill, highlighting the importance of addressing redundant employees, and plan to undertake a public expenditure review with World Bank assistance.

21. The authorities are fully aware of public debt risks. They expect the debt-GDP ratio to peak around 2016 and decline afterward with a gradual consolidation, and emphasized that the government's ceiling of 65 percent of GDP would not be breached. This would allow sufficient space for countercyclical policies. They noted that downside risks could exist if adverse external shocks materialized, or if SOE performance deteriorates, but they reiterated that public funds would not be used for banking sector restructuring.

B. Monetary and Exchange Rate Policy

22. Maintaining a supportive monetary stance is appropriate as long as inflation pressures remain absent. Evidence of an excess supply gap exists, growth is below potential, core inflation has declined, and wage pressures are benign. As well, the transmission of easier monetary conditions to credit growth appears to have been dampened in recent years (Box 4). At this juncture, easy monetary conditions do not pose a risk to financial stability. Real estate prices remain subdued and equity market price/earnings ratios are around 15 percent. Indeed, supportive liquidity conditions are currently facilitating banking system adjustment. If significant capital outflows were to occur, greater exchange rate flexibility should be the first line of defense, and consideration might also be given to raising domestic interest rates.

23. Moving gradually toward using inflation as a nominal anchor would provide a better framework for monetary policy. Currently there exist multiple targets and instruments, including broad money, bank credit, and various interest rates. A daily US$/VND exchange rate target is announced, with a band of ±1 percent. Maintaining a supportive stance and the exchange rate peg will be challenging in the near term if global interest rates rise. In the medium term, the economy will increasingly face asymmetric shocks and would benefit from an independent monetary policy. To start, the band for exchange rate fluctuation could be gradually widened, reforms initiated to promote a deep and liquid foreign exchange market and establish an interest rate instrument while reducing reliance on quantitative targets, liquidity forecasting and management improved, and monetary policy communications increasingly geared toward price stability.

24. Greater exchange rate flexibility would help absorb external shocks and facilitate reserves accumulation. The real effective exchange rate has appreciated by about 2 percent compared to a year ago. However, the results of CGER-type analysis and broader trends in the balance of payments suggest there is no convincing evidence of misalignment. Notwithstanding, further strengthening international reserve adequacy would improve resilience (Box 5).

25. The SBV viewed inflation control as a top priority since early 2011 to achieve a more stable macroeconomic environment conducive for structural reforms. Supportive monetary conditions remained appropriate in the near term, given low inflation and weak demand, as well as the dampened transmission mechanism that reflected economic restructuring, financial weaknesses, and low demand for credit. Despite the recent strong increase in reserves, the authorities considered further accumulation as desirable, to bring them more in line with adequacy metrics.

Box 4. Vietnam: The Effects of Monetary Policy on Bank Lending

Monetary policy generally affects the supply of bank credit through two channels. The first is direct and common across banks. The second may vary according to the financial position of each bank—the bank lending channel—whereby stronger banks are less reliant on central bank funding than weaker banks and therefore less responsive to changes in policy.[1] This box investigates the extent to which credit supply depends on policy rates in Vietnam, and if this relationship varies with banks' financial characteristics.

A model is estimated on a panel of balance sheet data for state-owned and other commercial banks over 2000–2013, using an Arellano-Bond GMM specification with fixed effects. To isolate the bank lending channel, the model introduces an interaction term between the policy interest rate and observed financial heterogeneity across banks. It controls for loan demand determinants, such as past loan growth, GDP growth, and the cyclical effects on banks' profitability, size, liquidity, capital, and borrowers' risk (loan loss provision); as well as unobserved heterogeneity, e.g., business models and risk propensity. Allowing for the possibility that monetary policy may affect credit decisions differently after the financial disruption in 2011, a time dummy interacting with relevant lagged explanatory variables is included. For bank *i* in period *t*, loan growth ($L_{i,t}$) is specified as follows:[2]

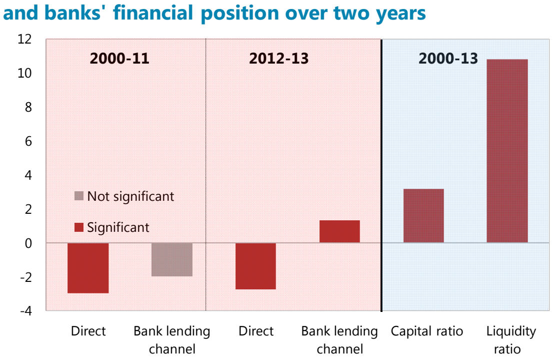
$$
\begin{aligned}
L_{i,t} = a_0 + a_1 L_{i,t-1} &+ \overbrace{\boxed{\left[\sum_{j=0}^{1} a_{2j} MP_{t-j} + \sum_{j=0}^{1} a_{3j} d_{t-j} MP_{t-j}\right]}}^{\textit{Direct Channel}} + \overbrace{\boxed{\left[\sum_{j=0}^{1} a_{4j} z_{i,t-j} MP_{t-j} + \sum_{j=0}^{1} a_{5j} d_{t-j} z_{i,t-j} MP_{t-j}\right]}}^{\textit{Bank Lending Channel}} \\
&+ \sum_{j=0}^{1} a_{6j} NGDP_{t-j} + a_{7j} ROE_{i,t-1} + a_{8j} LLP_{i,t-1} + a_{9j} z_{i,t-1} \\
&+ \sum_{j=0}^{1} a_{10j} w_{i,t-j} NGDP_{t-j} + \sum_{j=0}^{1} a_{11j} z_{i,t-j} NGDP_{t-j} + u_{i,t}
\end{aligned}
$$

Key findings: First, changes in monetary policy have an inverse direct impact on private credit growth that is common across banks.[3]

Second, the bank lending channel emerges after 2011. Credit supply by the banking system as a whole reacts less to policy rate changes compared to the earlier period, when the impact of policy did not vary with banks' financial positions. This channel has dampened the transmission mechanism.

Third, banks' health is an overwhelming factor determining credit supply. A weakening of banks lowers credit growth, *ceteris paribus*, while strengthening banks' capital and liquidity would have a vigorous positive impact on credit growth.

Elasticity of loan growth to changes in the refinancing rate, and banks' financial position over two years



At 10 percent statistical significance level.

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[1] See Kashyap and Stein (1995) on the role of bank size in monetary policy transmission mechanism; Kishan and Opiela (2000), Van der Heuvel (2002), and Bernanke (2007) on capitalization; and Kashyap and Stein (2000) and Chatelain and others (2003) on liquidity position.

[2] L denotes loan growth (y/y), excluding interbank positions; MP is the SBV's refinancing rate; NGDP is GDP growth (y/y); ROE is return on equity; LLP is loan loss provisions to asset ratio; w is a vector of ROE and LLP while z is a vector of bank size, liquidity ratio, and capital ratio, standardized across banks; and d =1 during 2012Q1–2013Q4, and 0 otherwise.

[3] The elasticities are in line with estimates for Germany, France, and Italy during 1999–2011 (De Santis and Surico, 2013).

Box 5. Vietnam: External Sector Assessment

CGER-type analysis based on the macro-balance and external sustainability approaches suggests the real exchange rate is moderately undervalued, requiring a 5–8 percent real effective appreciation to close the gap between the underlying and estimated current account norm, *ceteris paribus*. In contrast, after a sharp real appreciation in 2012–13 (reflecting high relative consumer price inflation), the equilibrium real exchange rate approach points to substantial overvaluation, with a real effective depreciation of about 16 percent needed to restore equilibrium. These results are well within the margin of error, which can be large.

Broader trends also suggest there is no convincing evidence of misalignment. The external balance of the FDI-intensive export-oriented sector remains in significant surplus, with the recent overall current account improvement largely reflecting a correction in the domestic economy, and thus cyclical weakness. Wages remain competitive, and foreign direct investment inflows remain robust. These considerations are tempered by the level of reserves (see below) and the risk of the exchange rate becoming overvalued if large public contingent liabilities are realized during bank restructuring.

Capital and financial account flows have been dominated by foreign direct investment and relatively smaller portfolio flows into the country's two stock markets. Despite the lack of large and internationally integrated capital markets, other financial flows have been quite volatile, as demonstrated by the large outflows recorded in the balance of payments in the second quarter of 2013 and large negative errors and omissions.

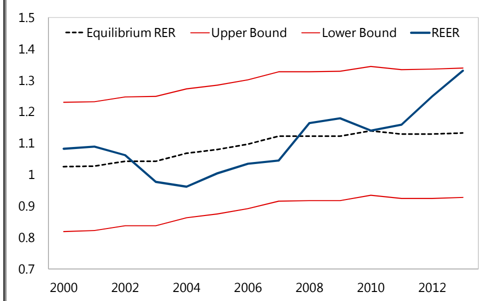
Although they increased recently, measured against several metrics Vietnam's international reserves are lower than before the global financial crisis, and below regional comparator countries. In early-2014, reserves made up about 2½ months of prospective imports of goods and services, well below the 8 months average of regional emerging market countries, and below the minimum level desirable for countries with a fixed exchange rate, according to the Fund's reserve adequacy metric.

Staff's overall assessment is that the external position would benefit from further strengthening. The relatively strong current account position is the result of productivity gains in the FDI-dominated export sector, a well diversified export base and markets, and the weak cyclical position of the domestic economy. As domestic demand recovers in the baseline scenario, the external position will likely deteriorate owing to high import elasticity. An accelerated pace of structural reforms beyond staff's baseline are needed to improve productivity, particularly in the domestic sector, and increase investment efficiency to bolster external sustainability. Fiscal consolidation, a more flexible exchange rate and higher reserves would also reduce vulnerabilities.

Approach	Macro-balance	External Sustainability 1/
Underlying current account balance	-1.9	-1.9
Current account norm	-4.8	-6.3
Required change in the current account	-2.9	-4.4
Implied over (+) / under (-) valuation	-5.2	-7.9

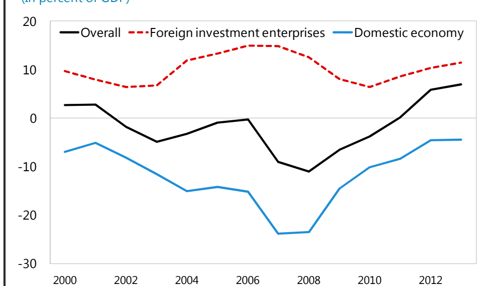
Source: IMF staff estimates.
1/ NFA norm of -68 percent of GDP.

Equilibrium Real Exchange Rate



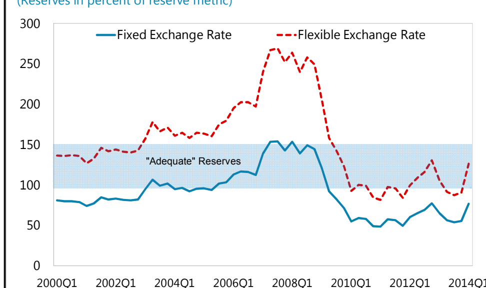
Source: IMF staff estimates.

External Current Account
(In percent of GDP)



Sources: Vietnamese authorities; and IMF staff estimates

Reserve Adequacy Metric Dynamics
(Reserves in percent of reserve metric)



Sources: Vietnamese authorities; and IMF staff estimates

Regional Comparison of Reserve Indicators

	Months of Imports of G&S 1/	Percent of Exports of G&S	Percent of Broad Money	Percent of Short-Term Debt	Percent of GDP
China	20	159	22	597	42
India	6	62	19	283	16
Indonesia	6	48	32	229	11
Malaysia	7	52	33	407	43
Philippines	11	115	54	492	31
Singapore	6	48	68	…	92
Sri Lanka	4	48	29	70	11
Thailand	7	59	32	292	43
Average 2/	8	74	36	339	36
Vietnam	3	25	17	331	21

Sources: Vietnamese authorities; IMF, *WEO* ; and staff estimates.
1/ In months of prospective imports of G&S.
2/ Excludes Singapore for short-term debt indicator.

26. The SBV broadly agreed with recommendations to enhance the monetary policy framework. The authorities explained that they had increasingly implemented monetary policy through short-term interbank interest rates, and were beginning to view money and credit targets as indicative. Liquidity forecasting had improved, and progress had been made in communicating the rationale for policy action to help guide market expectations. They noted that a stronger banking system and increased confidence in the currency would be needed to facilitate a smooth transition from the exchange rate to inflation as a nominal anchor over the medium term.

C. Banking Sector Reform

27. The implementation of several recent policy measures will help improve the functioning of the banking sector. Liquidity has improved thanks to accommodative monetary conditions and FDI and remittance inflows. Most banks have been asked to submit restructuring plans to the SBV. A new risk management regulation based on Basle II is being drafted and an adoption roadmap has been developed, which will be piloted in ten banks.[2] The VAMC has begun purchasing NPLs from commercial banks and is planning liquidation, restructuring, and outright sales to unwind them. Its capital will be increased. A revised bankruptcy law has been adopted and related legislation is under review to provide smoother enterprise restructuring and debt resolution. The limit on banks' single foreign owner was increased slightly under an unchanged overall foreign ownership cap of 30 percent.[3] A new Monetary and Financial Stability Department was created in the SBV, and the SBV has issued an action plan for the banking sector to supplement existing strategies.

28. Improved liquidity has given the banking system much needed breathing space, but a number of key problems remain. Asset quality remains under pressure from weak domestic activity and recent years' sharp decline in real estate prices, and profitability is low. Full implementation of tighter loan classification has been postponed, to 2015, allowing loan rescheduling and new lending to delinquent customers without reclassification, and some merged institutions are granted time to comply with key prudential norms. Banks have five years to provision against NPLs sold to the VAMC in exchange for bonds that are nonmarketable, pay no interest, and are not government guaranteed. Significant legal hurdles for the transfer of loan titles and collateral impede NPL resolution. The macroprudential framework requires refinement. Administrative levers including sector-specific lending directives and interest rate limits remain.

29. To be successful, reforms must address the root causes of the problem and be bold. Weak balance sheets, regulatory forbearance, connected lending and cross ownership (including between banks and SOEs), weak risk management, and the presence of special interest groups will result in credit being channeled to unprofitable and unproductive businesses and may become a drain on public resources both in the form of foregone earnings and potential recapitalization costs. International experience shows that a resumption of robust economic growth is unlikely as long as banks remain undercapitalized and the monetary policy transmission mechanism is impaired.

[2] The piloted banks are expected to implement the Basel II basic indicator approach and standardized approach by 2015 and 2018, respectively, while the remaining joint stock banks will have to comply with the basic indicator approach by 2018.

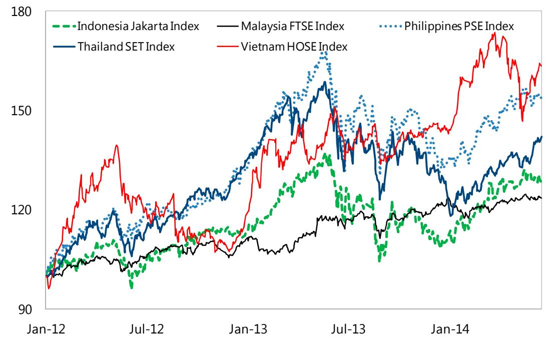
[3] Higher shares of foreign capital are allowed upon the Prime Minister's approval.

Figure 5. Overall financial conditions have improved, but banks remain weak

After posting sharp gains in the first quarter, the stock market has corrected.

Stock Market Performance 1/

(Index, January 2012=100)

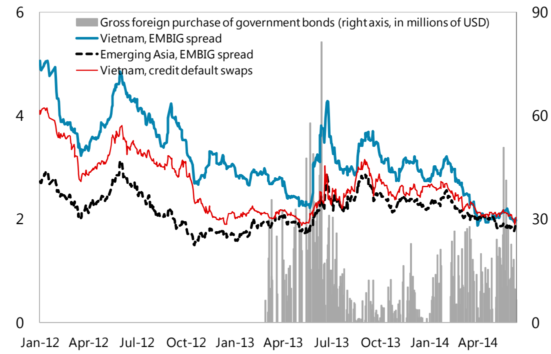


1/ Data as of June 16, 2014.

Sovereign spreads have narrowed by more than those in emerging Asia.

Sovereign Bond Spreads

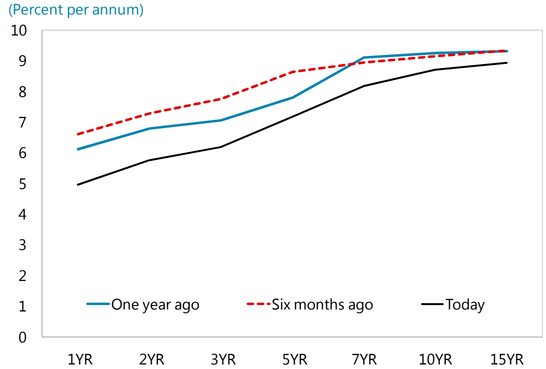
(In percentage points)



The government is facing a more favorable financing environment.

Domestic Bond Yield Curve

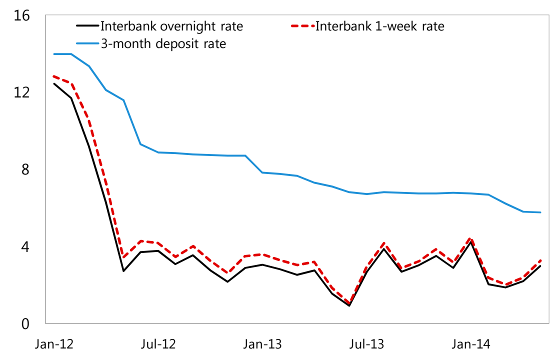
(Percent per annum)



Bank funding costs continue to decline...

Interest Rates

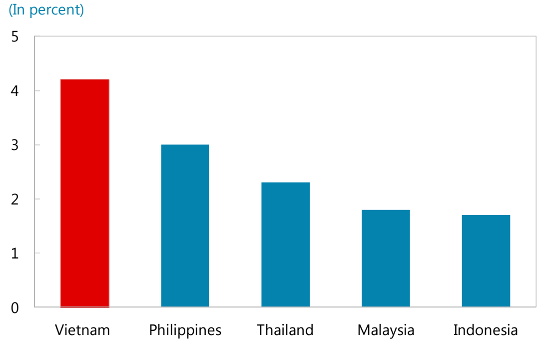
(In percent per annum)



...but asset quality is poor...

NPL Ratio 1/

(In percent)

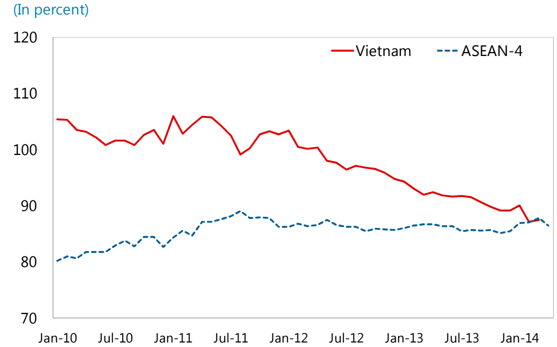


1/ Vietnam as of April 2014; Philippines as of September 2013; Thailand, Malaysia and Indonesia as of end-2013.

...and banks continue to deleverage.

Loan-to-Deposit Ratio 1/

(In percent)



1/ ASEAN-4 includes Indonesia, Malaysia, Philippines, and Thailand.

Sources: Vietnamese authorities; Bloomberg LP; IMF, WEO; and IMF staff estimates.

30. Staff recommended using breathing space created by improved liquidity conditions to adopt a more comprehensive and sequenced reform agenda (Box 6). Core pillars include: a more expeditious recognition of NPLs, supported by bank diagnostic assessments and legal and SOE reforms; restructuring and recapitalization of viable banks; and orderly exit of insolvent institutions, supported if necessary by a stronger safety net. A revamped VAMC, with ability to buy and sell impaired loans at market value as is currently under consideration, could play a significant role. The crisis management framework and supervision should be strengthened, and the use of administrative measures gradually eliminated.

31. The authorities agreed with the thrust of staff's recommendations, but argued for a more gradual pace. More time was needed to match banks' capacity to absorb losses generated by stricter regulatory standards, and to support the economic recovery. In their view, the root causes of banking sector weakness were clearly identified, forbearance had been tightened, banks were required to report NPLs to the SBV under stricter norms, and financial weaknesses were not systemic. The constraints imposed by the existing legal system and connected lending that complicate NPL resolution, and the decision not to use public funds for recapitalization, were well understood. The authorities acknowledged the recommendation that a comprehensive reform package, including solutions to tackle the constraints of budgetary resources and legal reforms, is needed to accelerate banking reform and NPL resolution. They emphasized that progress had been made in this process.

D. SOE Reform

32. SOE reform is progressing. Restructuring plans have been developed, and efforts are focused on amendments to the legal framework, divestment from noncore areas, and equitization. To improve the legal framework, the government has issued new regulations to enhance SOEs' financial reporting and transparency, improve internal controls by defining different government agency responsibilities, and improve corporate governance. To facilitate equitization, enterprises can now sell assets below book value with the approval of the government, and several have had IPOs.

33. While improvements to the legal framework are welcome, implementation remains a challenge, in part due to capacity constraints. Approved restructuring plans have been made public, but implementation progress is uneven, particularly among some SOEs' subsidiaries. Oversight of SOEs by government agencies is fragmented, and the focus on partial equitization risks diverting attention away from operational reforms to enhance efficiency. Public disclosure of SOEs' financial condition should be enhanced with timely publication based on international accounting practices.

34. Restructuring could be enhanced by several measures. A high-level steering committee to oversee the reform agenda, facilitate coordination among ministries, and monitor implementation would expedite progress. Expanding the scope of divestment beyond noncore areas would improve efficiency and level the playing field for the private sector, particularly if it were accompanied by external management expertise. Capacity at various ministries could be enhanced, and restructuring costs estimated to quantify fiscal implications.

Box 6. Vietnam: Bank Reform and Contingency Planning

Key pillars of a comprehensive reform include:

- *Assessing banks' recapitalization needs.* Prioritize systemically important banks and undertake diagnostic assessments: (i) on the basis of audits conducted by internationally reputed firms; (ii) under strict application of prudential norms; and (iii) accounting for connected lending, multiple gearing, and loan-financed equity injections.
- *Revising classification criteria to guide resolution options.* Based on the diagnostic assessments, modify banks' classification as: (i) healthy; (ii) undercapitalized but viable; or (iii) insolvent and nonviable. Identify systemically important institutions to determine resolution options.
- *Recapitalizing, restructuring and resolving.* Foreign strategic partnerships have provided welcome capital and management expertise for a number of banks, and the increase in single foreign ownership limit is welcome, although unlikely to provide significant new capital. Recapitalization of SOCBs immediately after the diagnostic assessments, along with elimination of forbearance and implementation of restructuring plans, would support confidence in the system and mitigate moral hazard. Undercapitalized but viable credit institutions should submit time-bound plans to raise capital to the regulatory minimum. Non-viable and insolvent institutions should be resolved in an orderly manner, supported by a legal framework for purchase and assumption transactions.
- *Strengthening the VAMC.* To contribute to effective NPL resolution, the VAMC will likely need more capital, in the form of equity rather than bonds, and an enabling legal framework to facilitate the transfer of loans and collateral. It should also be granted legal and operational independence and transparent governance, given incentives for rapid disposal of assets, and operate with a clearly defined sunset clause.
- *Developing additional options to deal with NPLs.* Other resolution options designed for different types of NPLs—which pose different legal challenges—include: (i) a court-led track for large and complex economic groups; (ii) a bank-led track, facilitated through legislation establishing a "pre-packaged" plan covering negotiation and approval mechanisms; and (iii) a special administrative restructuring track for selected SOEs financed exclusively by SOCBs. NPL resolution should be carried out in coordination with restructuring programs for the indebted SOEs.
- *Tightening supervision to ensure sound lending practices going forward.* Risk mitigation would require the immediate elimination of measures allowing lending to defaulted borrowers. Regulatory forbearance should be phased out as soon as feasible, while reform towards risk-based supervision continues over the medium term.
- *Revamping the architecture and procedures for crisis management*, including: (i) a senior policy group (SPG) for decision making comprising the SBV Governor, Minister of Finance and relevant deputies; (ii) a technical secretariat to provide daily reports and analysis to the SPG; (iii) preparation of templates for notifications and instructions to banks; and (iv) a communications strategy.
- *Strengthening financial safety nets during the reform process.* Extraordinary liquidity provision and extended coverage of deposit insurance (DI) may be necessary during the reform process, but the conditions under which they are provided and the funding of the DI should be identified ex-ante and in a fiscally transparent manner.

35. The authorities emphasized their efforts to develop the legal framework, and to improve the management and supervision of SOEs. They agreed that the current ownership structure of SOEs is fragmented. Equitization efforts are constrained by weak economic conditions, and budgetary resources are not available to fund SOE restructuring. The authorities hoped to make significant progress by end-2015. They also explained they are currently drafting a law to make dividend payments from profitable SOEs permanent.

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36. Vietnam has made significant progress with macroeconomic stabilization and important steps in banking and SOE reform. Growth is recovering and inflation has been reduced to mid-single digits, substantially lower than a few years ago. The current account remains in surplus and gross international reserves have risen in recent years. Banking system liquidity has improved, and steps toward bank restructuring—albeit gradual—are underway. The VAMC continues to purchase NPLs and is planning resolution. SOE reform has also moved forward with restructuring plans, amendments to the legal framework and equitization.

37. Nevertheless, economic growth remains below potential and important risks exist. Growth continues to be constrained by weak banks and inefficient SOEs. Public debt is rising and approaching a level that reduces fiscal space for critical expenditures and potential costs of banking and SOE reforms. The gradual pace of banking reform leaves the system vulnerable to adverse shocks and negative macro-financial feedback, which could undermine growth and add significantly to public sector debt. The economy is also vulnerable to spillovers from external shocks including surges in global financial volatility, slower trading partner growth and regional geopolitical tensions.

38. Fiscal consolidation that creates space for critical expenditures and possible contingent liabilities would reduce risk and support growth. A medium-term plan to return public debt to around 45 percent of GDP should be implemented in a growth-friendly manner, and would provide space for potential bank and SOE restructuring costs. Raising revenue would allow consolidation to take place while safeguarding social spending and well-targeted capital expenditure to support growth and inclusiveness. This is achievable with a strategy to broaden the base, improve administration, forego further corporate income tax rate reductions, and institutionalize SOE dividend payments to the budget. There is also space to rationalize public expenditure, including broader civil service reforms that raise efficiency and address the large public wage bill. Reforms to increase public investment efficiency are welcome.

39. The current monetary policy stance is appropriate and the monetary policy framework should gradually shift from the exchange rate to inflation as the nominal anchor. With output below estimated potential, supportive monetary conditions are appropriate as long as inflation pressures remain muted. The recent increase in international reserves is welcome, and greater exchange rate flexibility would help buffer shocks and facilitate higher reserve adequacy. Preparing the groundwork for moving toward inflation as a nominal anchor will be crucial for a successful transition. Initial steps could be taken to promote a deep and liquid foreign exchange market, initiate reforms to establish an interest rate instrument, improve liquidity forecasting and management, and gear policy communications toward price stability.

40. A comprehensive approach to banking sector restructuring is critical to reduce macro-financial risks and for sustainable robust economic growth. The current gradual approach charts a risky path forward. Not addressing weaknesses forcefully, and instead relying on de facto forbearance and liquidity will deprive economic growth of a key engine—new credit to profitable enterprises—and makes the system susceptible to adverse shocks and asset deterioration against which banks would not be adequately provisioned. This is compounded by a high risk of contagion brought about by cross-ownership among banks, and between banks and enterprises, with the potential for adverse feedback loops.

41. A more expeditious recognition of losses on NPLs, restructuring of viable banks, and an orderly exit of insolvent institutions is recommended. Prioritized diagnostic assessments of banks under application of stricter prudential norms would focus restructuring efforts and provide estimates of recapitalization costs. Recapitalization, including greater foreign participation and using public funds under strict conditions for systemically important institutions, elimination of forbearance, and continued strengthening of supervision would improve confidence, credit flows and the monetary policy transmission mechanism, and allocation of resources. Legal reforms to facilitate NPL resolution—beyond the revision to the bankruptcy law—are also needed. Plans to strengthen the VAMC with equity capital and the ability to buy and sell NPLs at market value are welcome. Additional options to deal with NPLs, such as bank- and court-led and administrative tracks, should also be considered. Finally, a stronger crisis management framework should be pursued.

42. Accelerating SOE reform will reduce risks and support growth by improving the allocation of resources. While the authorities have made progress, further efforts are needed to accelerate implementation and improve coordination of the reform agenda, which is fragmented over different agencies and ministries. It will be important that efforts go beyond partial equitization and focus on strengthening corporate governance and ensuring a level playing field.

43. It is recommended that the next Article IV Consultation take place on the standard 12-month cycle.

Table 1. Vietnam: Selected Economic Indicators, 2009–15 1/

	2009	2010	2011	2012	Est. 2013	Projections 2014	2015
Output							
Real GDP (percent change)	5.4	6.4	6.2	5.2	5.4	5.5	5.6
Prices (percent change)							
CPI (period average)	6.7	9.2	18.7	9.1	6.6	5.2	5.2
CPI (end of period)	6.5	11.7	18.1	6.8	6.0	5.3	5.0
Core inflation (end of period)	6.6	9.8	14.3	9.6	6.4	...	...
GDP deflator	6.2	12.1	21.3	10.9	4.8	6.4	6.2
General government finances (in percent of GDP) 2/							
Revenue and grants	25.6	27.3	25.9	22.6	22.9	20.3	20.1
Of which: Oil revenue	3.4	3.2	4.0	3.8	3.4	2.6	2.3
Expenditure	31.6	30.0	26.9	29.4	28.5	26.9	26.2
Expense	19.3	19.2	18.4	20.4	21.3	20.4	20.2
Net acquisition of nonfinancial assets	12.3	10.8	8.6	9.0	7.2	6.5	6.1
Net lending (+)/borrowing(-) 3/	-6.0	-2.8	-1.1	-6.8	-5.6	-6.6	-6.1
Public and publicly guaranteed debt (end of period)	46.9	48.4	46.7	48.5	51.6	54.8	57.1
Money and credit (percent change, end of period)							
Broad money (M2)	29.0	33.3	12.1	18.5	18.8	18.1	15.7
Credit to the economy	39.6	32.4	14.3	8.7	12.7	12.0	12.2
Interest rates (in percent, end of period)							
Nominal three-month deposit rate (households)	10.7	11.6	14.9	9.4	8.3	...	...
Nominal short-term lending rate (less than one year)	12.7	14.0	16.4	12.9	12.4	...	...
Balance of payments (in percent of GDP, unless otherwise indicated)							
Current account balance (including official transfers)	-6.5	-3.8	0.2	6.0	5.6	4.1	3.4
Exports f.o.b.	56.2	64.1	72.0	73.6	77.5	79.7	80.2
Imports f.o.b.	63.7	68.6	72.3	68.0	72.4	76.4	77.3
Capital and financial account	6.6	5.5	4.8	5.6	-0.1	2.3	1.9
Gross international reserves (in billions of U.S. dollars) 4/	14.1	12.4	13.5	25.4	26.0	38.0	48.8
In months of prospective GNFS imports	1.9	1.4	1.4	2.3	2.0	2.6	3.1
Total external debt (end of period)	38.0	38.8	38.8	38.0	38.5	38.1	38.3
Nominal exchange rate (dong/U.S. dollar, end of period)	18,479	19,498	21,035	20,825	21,105	...	...
Nominal effective exchange rate (end of period)	80.8	81.1	68.2	67.9	70.1	...	...
Real effective exchange rate (end of period)	116.0	117.4	122.5	127.5	136.1	...	...
Memorandum items:							
GDP (in trillions of dong at current market prices)	1,809	2,158	2,780	3,245	3,584	4,024	4,513
GDP (in billions of U.S. dollars)	101.6	112.8	134.6	155.6	170.6	187.8	204.5
Per capita GDP (in U.S. dollars)	1,181	1,297	1,532	1,753	1,902	2,073	2,233

Sources: Vietnamese authorities; and IMF staff estimates and projections.
1/ The national accounts has been re-based to 2010 from 1994 by the authorities.
2/ Follows the format of the *Government Finance Statistics Manual 2001* .
3/ Excludes net lending of the Vietnam Development Bank.
4/ Excludes government deposits.

Table 2. Vietnam: Balance of Payments, 2009-15 1/

(In billions of U.S. dollars, unless otherwise indicated)

					Est.	Projection	
	2009	2010	2011	2012	2013	2014	2015
Current account balance	-6.6	-4.3	0.2	9.3	9.5	7.8	7.0
Trade balance	-7.6	-5.1	-0.4	8.7	8.7	6.2	6.0
Exports, f.o.b.	57.1	72.2	96.9	114.5	132.1	149.7	164.1
Imports, f.o.b.	64.7	77.4	97.4	105.8	123.4	143.5	158.1
Nonfactor services	-2.4	-2.5	-3.2	-1.4	-1.4	-2.3	-2.5
Receipts	5.8	7.5	8.7	9.6	10.5	11.7	12.7
Payments	8.2	9.9	11.9	11.1	11.9	14.0	15.1
Investment income	-3.0	-4.6	-4.8	-6.2	-7.3	-5.8	-6.5
Receipts	0.8	0.5	0.4	0.3	0.3	0.3	0.3
Payments	3.8	5.0	5.2	6.5	7.6	6.1	6.7
Transfers	6.4	7.9	8.7	8.2	9.5	9.7	10.0
Private (net)	6.0	7.6	8.3	7.9	8.9	9.1	9.4
Official (net)	0.4	0.3	0.4	0.3	0.6	0.6	0.5
Capital and financial account balance	6.8	6.2	6.5	8.7	-0.2	4.3	3.8
Direct investment (net)	6.9	7.1	6.6	7.2	6.9	7.0	7.2
Of which: Foreign direct investment in Vietnam	7.6	8.0	7.5	8.4	8.9	9.1	9.4
Portfolio investment	-0.1	2.4	1.5	2.0	1.5	1.9	2.0
Medium- and long-term loans	4.5	2.8	3.3	4.3	3.4	4.2	3.8
Disbursements	6.1	4.7	5.7	7.8	8.1	7.9	7.2
ODA loans	6.9	3.9	7.1	6.6	5.0	5.0	5.8
Commercial loans	-0.8	0.8	-1.4	1.2	3.1	2.9	1.4
Amortization	1.7	1.9	2.4	3.5	4.7	3.7	3.4
Short-term capital 2/	-4.5	-6.0	-4.8	-4.7	-11.9	-8.8	-9.2
Net foreign assets	-4.8	-7.1	-6.4	-6.0	-12.0	-11.8	-7.1
Of which: Commercial banks	...	-0.5	0.4	0.1	-2.3	-0.3	-0.2
Trade credit (net)	0.3	1.0	1.6	1.3	0.1	0.7	0.5
Other short-term capital	...	...	... ...	...	...	2.5	-2.5
Errors and omissions	-9.0	-3.7	-5.6	-6.1	-8.8	0.0	0.0
Overall balance	-8.9	-1.8	1.1	11.9	0.6	12.0	10.8
Memorandum items:							
Gross international reserves 3/	14.1	12.4	13.5	25.4	26.0	38.0	48.8
In months of prospective GNFS imports	1.9	1.4	1.4	2.3	2.0	2.6	3.1
Current account balance (in percent of GDP)	-6.5	-3.8	0.2	6.0	5.6	4.1	3.4
Export value (percent change)	-8.9	26.5	34.2	18.2	15.4	13.3	9.7
Export value (in percent of GDP)	56.2	64.1	72.0	73.6	77.5	79.7	80.2
Import value (percent change)	-14.3	19.6	25.8	8.7	16.6	16.2	10.2
Import value (in percent of GDP)	63.7	68.6	72.3	68.0	72.4	76.4	77.3
External debt	37.2	43.0	51.3	59.2	65.5	70.5	77.2
In percent of GDP 4/	38.0	38.8	38.8	38.0	38.5	38.1	38.3
GDP	101.6	112.8	134.6	155.6	170.6	187.8	204.5

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ Data up to 2009 reflect an old presentation; from 2010, part of errors and omissions began to be reflected in net foreign assets.

2/ Incorporates a projection for negative errors and ommissions going forward.

3/ Excludes government deposits; data for 2009 include the SDR allocation of SDR 267.1 million.

4/ Uses interbank exchange rate.

Table 3. Vietnam: General Government Budgetary Operations, 2009–15 1/

					Estimates	Projections	
	2009	2010	2011	2012	2013	2014	2015
			(In trillions of dong)				
Total revenue and grants	463	588	719	733	821	819	909
Tax revenue	373	483	608	617	676	713	792
Oil revenues	61	69	110	125	120	105	103
Non-oil tax revenues	312	414	497	493	555	608	689
Grants	8	12	12	10	5	5	5
Other revenue	82	93	100	106	140	100	113
Expenditure	572	648	749	954	1021	1083	1184
Expense	349	414	511	662	762	820	911
Interest	20	25	30	40	48	60	65
Other expense	328	389	481	622	714	760	845
Net acquisition of non-financial assets	223	234	238	292	259	263	273
Net lending (+)/borrowing (-)	-109	-59	-29	-221	-200	-264	-275
Net incurrence of financial liabilities	125	181	112	222	278	280	291
Domestic	32	92	55	176	185	208	196
Securities	-2	60	33	115	130	…	…
Loans	34	33	22	61	55	…	…
Foreign	93	89	56	47	93	72	95
Disbursement	103	99	80	75	121	105	121
Amortization	10	10	24	28	27	32	27
Net acquisition of financial assets	-16	-121	-82	-2	-78	-16	-16
			(In percent of GDP, unless otherwise indicated)				
Revenue	25.6	27.3	25.9	22.6	22.9	20.3	20.1
Tax revenue	20.6	22.4	21.9	19.0	18.8	17.7	17.5
Oil revenues	3.4	3.2	4.0	3.8	3.4	2.6	2.3
Non-oil revenues	17.2	19.2	17.9	15.2	15.5	15.1	15.3
Grants	0.4	0.5	0.4	0.3	0.1	0.1	0.1
Other revenue	4.5	4.3	3.6	3.3	3.9	2.5	2.5
Expenditure	31.6	30.0	26.9	29.4	28.5	26.9	26.2
Expense	19.3	19.2	18.4	20.4	21.3	20.4	20.2
Interest	1.1	1.2	1.1	1.2	1.3	1.5	1.4
Other expense	18.2	18.0	17.3	19.2	19.9	18.9	18.7
Net acquisition of non-financial assets	12.3	10.8	8.6	9.0	7.2	6.5	6.1
Net lending (+)/borrowing (-)	-6.0	-2.8	-1.1	-6.8	-5.6	-6.6	-6.1
Net incurrence of financial liabilities	6.9	8.4	4.0	6.9	7.8	7.0	6.5
Domestic	1.7	4.3	2.0	5.4	5.2	5.2	4.4
Securities	-0.1	2.8	1.2	3.5	3.6	…	…
Loans	1.9	1.5	0.8	1.9	1.5	…	…
Foreign	5.2	4.1	2.0	1.4	2.6	1.8	2.1
Disbursement	5.7	4.6	2.9	2.3	3.4	2.6	2.7
Amortization	0.6	0.5	0.9	0.9	0.8	0.8	0.6
Net acquisition of financial assets	-0.9	-5.6	-3.0	0.0	-2.2	-0.4	-0.4
Memorandum items:							
Public and publicly guaranteed debt	46.9	48.4	46.7	48.5	51.6	54.8	57.1
Net ODA onlending	0.4	1.7	0.5	0.5	0.4	0.4	0.4
Primary balance	-4.9	-1.6	0.0	-5.6	-4.2	-5.1	-4.6
Non-oil primary balance	-8.3	-4.8	-4.0	-9.4	-7.6	-7.7	-6.9
Cyclically adjusted NOPB	-7.8	-4.9	-4.3	-9.3	-7.3	-7.5	-6.9
Fiscal stance	3.4	-0.2	-1.8	4.0	2.6	3.5	2.9
Fiscal impulse	5.3	-3.6	-1.6	5.8	-1.4	0.8	-0.6
Nominal GDP (in trillions of dong)	1,809	2,158	2,780	3,245	3,584	4,024	4,513

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ Government Finance Statistics 2001 presentation.

Table 4. Vietnam: Monetary Survey, 2009–15 1/
(In trillions of dong at end-period, unless otherwise indicated)

	2009	2010	2011	2012	Est. 2013	Projections 2014	Projections 2015
Net foreign assets	312	267	300	548	613	902	1,180
State Bank of Vietnam (SBV)	281	224	271	522	540	820	1,093
Commercial banks	31	43	29	26	73	81	88
Net domestic assets	1,780	2,523	2,826	3,155	3,788	4,297	4,837
Domestic credit	2,040	2,690	3,063	3,404	3,876	4,458	5,085
Net claims on government	170	214	232	326	407	572	725
SBV	76	82	55	43	…	…	…
Credit institutions	94	132	177	283	…	…	…
Credit to the economy	1,869	2,476	2,830	3,078	3,470	3,886	4,360
Claims on state-owned enterprises (SOEs) 2/	550	464	489	524	573	…	…
Claims on other sectors	1,319	2,012	2,341	2,553	2,897	…	…
In dong	1,542	1,990	2,264	2,540	3,010	…	…
In foreign currency	327	485	567	538	460	…	…
By state-owned banks (SOCBs)	887	1,107	1,270	1,427	1,625	…	…
By non-SOCBs	982	1,369	1,560	1,651	1,844	…	…
Other items net	-260	-167	-237	-249	-88	-161	-248
Total liquidity (M2)	2,092	2,789	3,126	3,703	4,401	5,199	6,017
Dong liquidity	1,665	2,273	2,588	3,228	3,852	…	…
Deposits	1,372	1,935	2,217	2,773	3,345	3,952	…
Currency outside banks	293	338	371	456	507	…	…
Foreign currency deposits	427	517	538	475	549	649	…
Memorandum items:							
Money multiplier 3/	5.0	6.3	6.0	5.6	6.3	6.3	6.3
Velocity	0.9	0.8	0.9	0.9	0.8	0.8	0.8
Reserve money (year-on-year percent change)	11.4	4.1	18.9	25.4	6.1	18.6	16.4
Liquidity (M2; year-on-year percent change)	29.0	33.3	12.1	18.5	18.8	18.1	15.7
Currency/deposits (in percent)	16.3	13.8	13.5	14.0	13.0	…	…
Credit/deposits (total, in percent)	103.9	101.0	102.7	94.8	89.1	84.5	81.9
Credit/deposits (dong, in percent)	112.4	102.9	102.1	91.6	90.0	…	…
Credit/deposits (foreign currency, in percent)	76.5	93.9	105.3	113.3	83.7	…	…
Credit to the economy							
Total (in percent of GDP)	99.1	114.7	101.8	94.8	96.8	96.6	96.6
Total (year-on-year percent change)	39.6	32.4	14.3	8.7	12.7	12.0	12.2
In dong (year-on-year percent change)	44.1	29.0	13.7	12.2	18.5	…	…
In FC (year-on-year percent change)	21.7	48.4	16.8	-5.1	-14.5	…	…
In FC at constant exchange rate (year on year percent change)	15.1	40.7	6.1	-5.0	-15.3	…	…
To SOEs (year-on-year percent change) 2/	32.9	-15.7	5.4	7.2	9.2	…	…
To other sectors (year-on-year percent change) 2/	42.5	52.5	16.4	9.1	13.5	…	…
To SOEs (percent of total) 2/	29.4	18.7	17.3	17.0	16.5	…	…
Dollarization							
Foreign currency deposits/total deposits (in percent)	23.7	21.1	19.5	14.6	14.1	…	…
Foreign currency loans/total loans (in percent)	17.5	19.6	20.0	17.5	13.3	…	…
Banks' net foreign exchange position (millions of U.S. dollars) 4/	-3,886	583	2,816	4,277	-796	…	…
Government deposits (in percent of GDP)	3.1	2.7	2.4	2.3	2.8	…	…
Nominal GDP (in trillions of dong)	1,809	2,158	2,780	3,245	3,584	4,024	4,513

Sources: SBV; and IMF staff estimates and projections.
1/ Includes the SBV and deposit-taking credit institutions.
2/ Break in series in 2010.
3/ M2 over reserve money.
4/ At interbank exchange rate; excludes SBV credit to credit institutions.

Table 5. Vietnam: Medium-Term Projections, 2009–19

	2009	2010	2011	2012	Est. 2013	Projections 2014	2015	2016	2017	2018	2019
Output					(Percent change)						
Real GDP	5.4	6.4	6.2	5.2	5.4	5.5	5.6	5.7	5.8	5.9	6.0
Prices											
CPI (period average)	6.7	9.2	18.7	9.1	6.6	5.2	5.2	4.9	4.7	4.6	4.5
CPI (end of period)	6.5	11.7	18.1	6.8	6.0	5.3	5.0	4.8	4.6	4.5	4.5
GDP deflator	6.2	12.1	21.3	10.9	4.8	6.4	6.2	4.2	5.1	4.3	4.4
General government finances 1/					(In percent of GDP, unless otherwise indicated)						
Revenue and grants	25.6	27.3	25.9	22.6	22.9	20.3	20.1	20.1	20.3	20.4	20.5
Expenditure	31.6	30.0	26.9	29.4	28.5	26.9	26.2	25.8	25.3	24.7	24.6
Expense	19.3	19.2	18.4	20.4	21.3	20.4	20.2	20.2	20.2	20.0	20.0
Net acquisition of nonfinancial assets	12.3	10.8	8.6	9.0	7.2	6.5	6.1	5.6	5.1	4.7	4.7
Net lending (+)/borrowing(-)	-6.0	-2.8	-1.1	-6.8	-5.6	-6.6	-6.1	-5.7	-4.9	-4.3	-4.1
Non-oil primary balance	-8.7	-6.5	-4.5	-9.9	-8.0	-8.1	-7.3	-6.5	-5.4	-4.5	-4.1
Public and publicly guaranteed debt (end of period)	46.9	48.4	46.7	48.5	51.6	54.8	57.1	59.5	60.3	60.7	60.7
Balance of payments											
Current account balance	-6.6	-3.8	0.2	6.0	5.6	4.1	3.4	2.6	1.2	-0.7	-1.9
Exports f.o.b.	57.1	64.1	72.0	73.6	77.5	79.7	80.2	81.8	81.6	81.8	80.6
Imports f.o.b.	64.7	68.6	72.3	68.0	72.4	76.4	77.3	79.4	80.6	82.7	82.5
Capital and financial account (net)	6.6	5.5	4.8	5.6	-0.1	2.3	1.9	2.7	3.1	3.4	3.5
Gross international official reserves (in billions of U.S. dollars)	14.1	12.4	13.5	25.4	26.0	38.0	48.8	60.4	70.8	77.8	82.1
In months of prospective GNFS imports	1.9	1.4	1.4	2.3	2.0	2.6	3.1	3.4	3.6	3.7	3.6
Total external debt (in billions U.S. dollars)	37.2	43.0	51.3	59.2	65.5	70.5	77.2	84.3	92.5	100.1	106.8
In percent of GDP	38.0	38.8	38.8	38.0	38.5	38.1	38.3	38.9	39.1	39.0	38.3
Memorandum items:											
Nominal GDP (in trillions of dong)	1,809	2,158	2,780	3,245	3,584	4,024	4,513	4,973	5,530	6,108	6,761
Nominal GDP (in billions of U.S. dollars)	101.6	112.8	134.6	155.6	170.6	187.8	204.5	219.4	238.8	259.0	281.4
Per capita GDP (in U.S. dollars)	1,181	1,297	1,532	1,753	1,902	2,073	2,233	2,371	2,554	2,741	2,948

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ Follows the format of the *Government Finance Statistics Manual 2001* .

Table 6. Vietnam: Progress Toward the Millennium Development Goals 1/

Goal/Target		Progress	Status
Goal 1: Eradicate extreme poverty and hunger			
Target 1	Reduce extreme poverty by half between 1990 and 2015	Poverty reduced by three-quarters between 1990 and 2008	Achieved
Target 2	Ruduce hunger by half between 1990 and 2015	Proportion of population below minimum consumption reduced by more than three-quarters between 1993 and 2012	Achieved
Goal 2: Achieve universal primary education			
Target 3	Universal primary schooling by 2015	Net enrollment ratio in primary education at 99.4 enrolees per 100 children	Likely to be achieved
Goal 3: Promote gender equality			
Target 4	Eliminate gender gaps in primary education no later than 2015	Ratio of girls to boys in primary education of 0.94	Close to parity
Goal 4: Reduce child mortality			
Target 5	Reduce by two-thirds between 1900 and 2015, the under-five mortality rate	Reduced by more than half between 1990 and 2012 (down from 51 to 23 deaths per 1,000)	Likely to be achieved
Goal 5: Improve maternal health			
Target 6	Reduce maternal mortality by three-quarters, between 1990 and 2015	Fell by 75 percent, from 240 per 100,000 births in 1990 to 59 in 2010	Achieved
Goal 6: Combat HIV/AIDS and other diseases			
Target 7	By 2015, halt and begin to reverse the spread of HIV/AIDS	Infection rate was 0.04 per year per 100 people aged 15-49 in 2011	Likely to be achieved
Target 8	By 2015, halt and reverse the incidence of tuberculosis (TB)	Cases severely reduced; with only 33 TB-related deaths per 100,000 in 2011	Likely to be achieved
Goal 7: Ensure environmental sustainability			
Target 9	Embrace sustainability and reverse the loss of forests	Forest cover up but loss in closed-canopy forest and biodiversity	Likely to be achieved
Target 10	Halve by 2015, share of people without safe drinking water and basic sanitation	Rapid progress on drinking water, much slower on hygienic sanitation	Uncertain to be achieved

Sources: United Nations Development Program, General Statistics Office of Vietnam, and the World Bank.

1/ As of December 2013.

INTERNATIONAL MONETARY FUND

VIETNAM

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

July 15, 2014

Approved By
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Prepared by the staffs of the International Monetary Fund and the International Development Association in consultation with the Asian Development Bank

Based on the LIC Debt Sustainability Analysis (DSA), Vietnam is at low risk of external debt distress.[1] *Although public and publicly guaranteed (PPG) external debt and total public debt are below vulnerability thresholds and benchmarks under the baseline scenario, overall debt is becoming a concern due to an increase in domestic debt and prospects for loose fiscal policy going forward. Public debt indicators are significantly higher than in the previous DSA, and are projected to worsen in the medium-term before beginning to decline. Specifically, the PPG debt ratio is expected to rise to around 60 percent of GDP in 2017 before falling to around 48 percent of GDP at the end of the projection period. The ratio of debt service to revenue is also projected to rise throughout most of the projection period as the level of concessionality of Vietnam's debt is projected to decline. A scenario that keeps the primary fiscal deficit fixed at its 2013 level would result in unsustainable debt dynamics. An alternative scenario that simulates banking sector distress could also bring the present value (PV) of debt-to-GDP ratio above the benchmark for public debt for most of the projection period.*[2]

[1] Vietnam's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment, averaged 3.8 over the past three years, placing it as a "strong performer." The relevant indicative thresholds for this category are 50 percent for the present value (PV) of the debt-to-GDP ratio, 200 percent for the PV of the debt-to-exports ratio, 300 percent for the PV of the debt-to-revenue ratio, 25 percent for the debt service-to-exports ratio, and 200 percent for the debt-service-to-revenue-ratio. These thresholds are applicable to public and publicly guaranteed (PPG) external debt.

[2] This DSA was prepared jointly by Bank and Fund staff, in consultation with the Asian Development Bank (AsDB). The debt data underlying this exercise were provided by the Vietnamese authorities and donor partners. Data beyond end-2013 are staff estimates and projections.

A. Background

1. **Vietnam's debt has been rising rapidly in recent years.** This has mainly been due to increases in the PPG domestic debt, while external debt has been relatively stable. At end-2013, the total external debt (including private sector debt) amounted to 38.5 percent of GDP, while the public and PPG external debt amounted to 26.5 percent of GDP. The domestic PPG debt amounted to 25 percent in 2013, leading the total PPG debt (domestic and external) to 51.6 percent of GDP. The recent increase in domestic debt is mainly related to domestic fiscal financing requirements in 2012–13, which were significantly higher than projected during the last DSA.

2. **This DSA covers the public and publicly guaranteed external debt and the domestic debt of the general public sector,** including the central government, local governments and state-owned enterprises (SOEs). On the external side, 11 percent of GDP is owed to multilateral creditors, 9½ percent of GDP to bilateral creditors, and 1 percent of GDP to commercial creditors. An additional 5 percent of GDP is publicly guaranteed debt of SOEs, largely commercial. Private external debt is estimated at 5.6 percent of GDP. The level of concessionality of PPG external debt has a grant element estimated at about 12 percent.

3. **On the domestic side, about 13 percentage points of GDP of domestic debt consists of marketable and nonmarketable securities** (bonds) and about 6 percentage points consists of loans and advances from the private sector financial institutions. An additional 6 percentage points consists of domestic publicly guaranteed debt of the SOEs. Domestic debt is in local currency and the effective nominal interest rate has remained at around 5 percent between 2010 and 2013. The government issues bonds in the domestic market, with an average term at 3.8 years in 2013, and a coupon ranging from 7.5 to 9 percent. These are mostly held by banks, with a small proportion (about 7 percent of the outstanding stock) held by nonresidents.

B. Underlying Assumptions

4. **The assumptions for this DSA differ from the previous DSA in a number of areas** (Box 1):

- *Slightly higher near-term growth*. The previous DSA had real GDP growth rising to 5½ percent through 2020, and stable thereafter. This DSA assumes real GDP growth rising gradually to 6 percent through 2020 in line with potential, and then declining in the long term to 5½ percent as the demographic dividend abates and the economy matures.

- *Lower inflation*. This is in line with the lower inflation outcome for 2013 and projections for a continued negative output gap in the medium-term, closing only gradually.

- *Higher net borrowing by the government.* The previous DSA assumed a fiscal consolidation starting in 2013. This DSA assumes that net borrowing by the government continues at a high level in line with a loose fiscal policy through 2017 that brings the debt ratio to 60 percent of GDP, before beginning a gradual consolidation thereafter.

- *The authorities' financing strategy going forward relies increasingly on domestic debt*, as they have emphasized the need to develop the domestic debt market. In addition, as the concessionality of external debt is reduced in line with Vietnam's graduation from low-income status in 2017, the advantage of accessing external debt will diminish.

C. External DSA

5. Under the baseline scenario, the ratio of the PV of PPG external debt to GDP is projected to decline in the long-term, and to remain well below the relevant thresholds (Figure 1). In addition, the ratio of the PV of PPG external debt to exports and to revenue also declines gradually during the projection period and remains well below the relevant thresholds. The debt-service to revenue ratio is projected to rise in the medium-term before declining gradually, largely because the grace period for recent borrowing is ending and revenue growth is projected to slow down. If remittances are included in the denominator of the debt indicator calculations these results continue to hold.

6. Alternative scenarios suggest that the PV of PPG external debt is most sensitive to a one-time depreciation of the exchange rate, but even under these scenarios the debt would remain well below thresholds. Under an historical scenario stress test (not shown in the charts), which projects debt ratios based on real GDP growth, the GDP deflator, the non-interest current account and new FDI flows set at their 10-year historical average, the ratios of the present value of debt to GDP, exports and revenue would all become negative over the long-term. This reflects the historical non-interest current account surplus, the high level of FDI inflows and the high grant element of Vietnam's external debt in the last 10 years.

D. Public DSA

7. Public debt remains below the thresholds for distress in the baseline, but without a gradual consolidation the risk of debt distress could rise rapidly (Figure 2). Public sector debt is projected to increase in nominal terms, reaching around 60 percent of GDP by 2017. As noted above, the assumptions underlying this scenario are that a gradual consolidation takes place such that the debt ratio begins to decline after reaching this level from 2020 forwards. The ratio of the PV of debt to GDP also rises before beginning a gradual decline. However, at all times it is below the benchmark of 74 percent of GDP.

8. Alternative scenarios highlight the growing vulnerability to debt distress. The scenario that keeps the primary balance at its 2013 level (a deficit of 4 percent of GDP) would result in the PV of debt to GDP becoming unsustainable and rising throughout the projection period. Under the alternative scenario that includes a one-time nominal depreciation of the exchange rate by 30 percent in the first year of the projection period (the most extreme shock), the ratio of the PV of debt to GDP rises to about 10 percentage points below the benchmark in 2016–18 before beginning to decline thereafter. These scenarios illustrate the increased risk that the current profile of debt and fiscal policy imply for public debt.

9. Under a customized scenario that simulates banking sector distress, the public debt would breach the benchmark. The scenario assumes an additional 15 percent of GDP in liabilities absorbed by the government over the first two years of the projection period, with GDP growth falling to 3 percent in both years before returning to its baseline path. Additional debt is assumed to be domestic and on similar terms to the current domestic debt (five years maturity and 7 percent coupon). Under this scenario the PV of debt to GDP would hit the benchmark of 74 percent around 2019 and remain above the benchmark for most of the projection period. The PV of debt to revenue ratio would rise to over 350 percent, and the debt service to revenue ratio would rise to over 70 percent in the long-term. These ratios would be higher if financing conditions were less favorable.

E. Conclusion

10. Debt indicators remain below thresholds for distress, but are moving toward increasing risk. Current indicators place Vietnam at low risk of debt distress. For external debt, Vietnam's current account surpluses and foreign direct investment flows help keep the risk of debt distress well below benchmark levels. However, for the total public debt, the fixed primary balance stress test indicates that maintaining primary deficits at their current level going forward would result in an increase of the ratio of PV of debt to GDP to unsustainable levels. As well, domestic interest rates and/or private external debt could increase as public financing pressures build. A worst case scenario stress test for the public debt (a one-time nominal depreciation of 30 percent in the first year of the projection period) would bring the PV of debt to GDP ratio to within 10 percent of the threshold level for debt distress in 2016–18. A bank distress scenario that adds 15 percent of GDP to the public debt in two years would bring the public debt above the threshold for most of the projection period. This highlights the increasing vulnerability of Vietnam's current debt path, particularly to a large debt shock.

11. The authorities broadly agree with the DSA. They agree that the risk of external debt distress remains very low, but the profile of public debt has worsened relative to last year. The authorities see the recent public debt increase as necessary to finance ongoing public investment projects, but recognize that it is reaching levels that warrant increased attention. Nevertheless, they pointed out that the debt ratio remains well below the 65 percent of GDP limit that has been imposed by the National Assembly. Should debt continue to rise as in the baseline, the authorities stated that they would begin a consolidation. They recognize the risks surrounding the strategy to address banking and SOE reforms, but continued to emphasize that budgetary resources would not be used to recapitalize banks or restructure SOE debt.

Box 1. Vietnam: Key Macroeconomic Assumptions for the Baseline Scenario, 2014–34

Real GDP growth is projected at 5.6 percent in 2014, and rising gradually to 6 percent in 2018–2020. After 2020 growth is projected to decline gradually to 5½ percent as the demographic dividend dissipates and the economy matures.

Inflation is projected to decline gradually from its level of 6 percent in 2013 to 4½ percent in the medium- and long-term. This is related to a negative output gap, and in the long run an assumed implicit policy objective of maintaining inflation around mid-single digits.

The current account is expected to remain in surplus in the near-term due to strong export growth related to foreign direct investment and demand from major trading partners, while imports remain subdued in line with domestic economic activity. In the medium-term the current account is expected to deteriorate as the economy recovers, and reach the deficit "norm" of 4½ percent in the long term, mostly financed by continued FDI flows.

The capital and financial account surplus which moved into a small deficit in 2013 is projected to continue to be negative in 2014 as international interest rates rise. In the medium-term the capital and financial account is expected to stabilize at a surplus of around 3½ percent of GDP related to FDI inflows and a gradual expansion and opening of the domestic capital market.

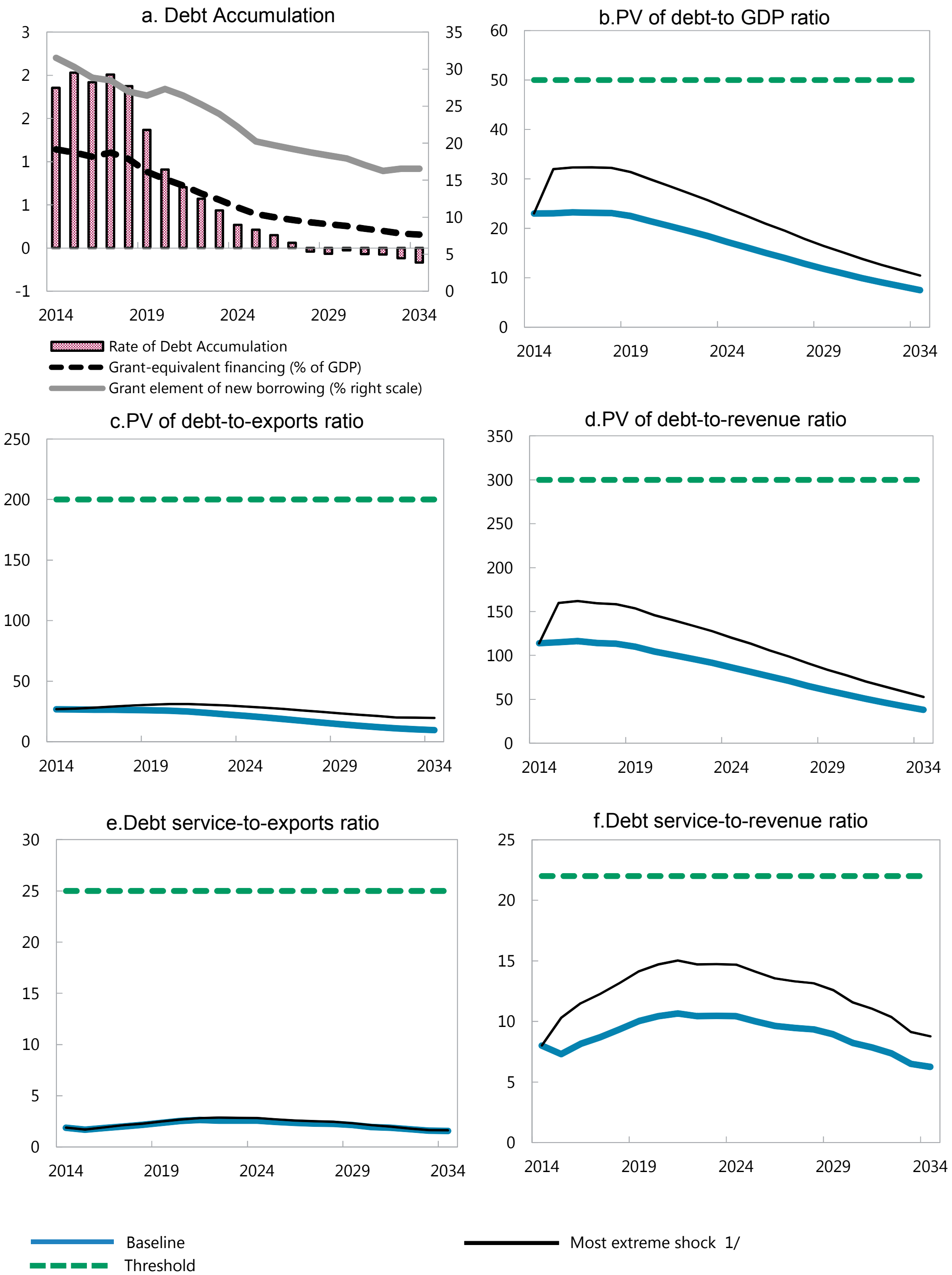
Reserve coverage is expected to remain at around 2½ months of imports in 2014, but to rise to about 3½ months of imports by 2016 and stabilize at this level thereafter.

The effective average interest rate on foreign borrowing is expected to be about 2 percent in 2014 reflecting the concessionality of borrowing in the short-term, but to rise to about 3½ percent in the long run. Interest rates on external borrowing are expected to rise only gradually as the average maturity of the current external debt is long (over 12 years) and most loans (over 90 percent) are at fixed interest rates.

Net borrowing by government is projected to be high in 2014, and continue at a high though declining level through 2017, to bring the debt ratio to around 60 percent of GDP. It is expected to decline in the long run, to bring the overall debt ratio to around 48 percent of GDP by 2034. The primary deficit is expected to be around 5 percent of GDP in 2014 and to decline gradually to around 2 percent of GDP in 2019. Maturing international bonds are assumed to be rolled over.

Contingent liabilities or exceptional financing are not assumed in the baseline scenario.

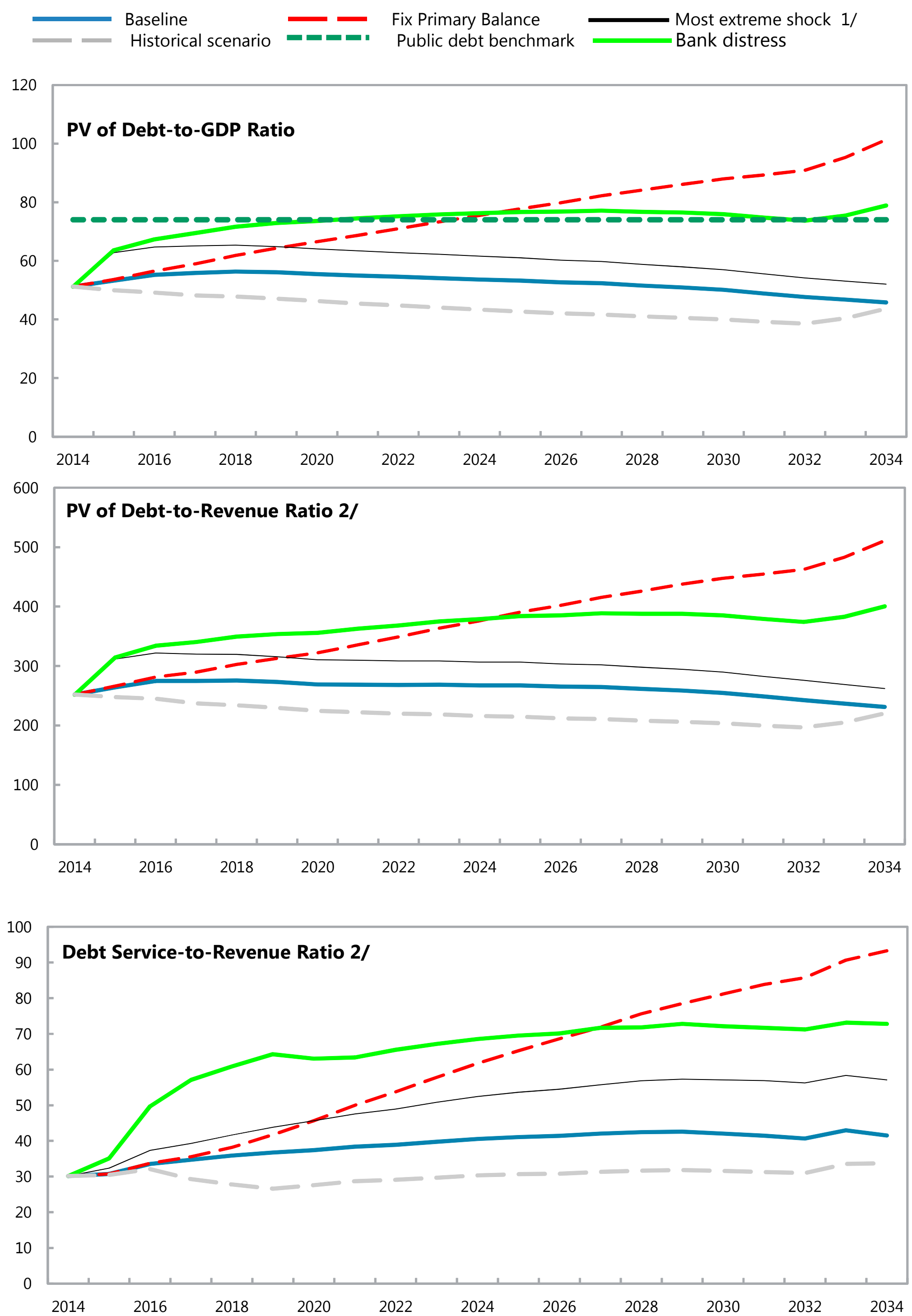
Figure 1. Vietnam: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2014-2034 1/



Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock.

Figure 2. Vietnam: Indicators of Public Debt - Alternative Scenarios, 2014-2034 1/



Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.
2/ Revenues are defined inclusive of grants.

Table 1. Vietnam: External Debt Sustainability Framework, Baseline Scenario, 2011-34 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-2019 Average	2024	2034	2020-2034 Average
External debt (nominal) 1/	**38.8**	**38.0**	**38.5**			**38.1**	**38.3**	**38.9**	**39.1**	**39.0**	**38.3**		**31.7**	**17.9**	
of which: public and publicly guaranteed (PPG)	28.3	27.0	26.5			26.4	26.7	27.1	27.3	27.5	27.1		21.8	10.1	
Change in external debt	0.2	-0.8	0.4			-0.4	0.2	0.7	0.2	-0.1	-0.7		-1.4	-1.7	
Identified net debt-creating flows	-11.1	-15.7	-13.3			-10.1	-9.2	-8.4	-6.9	-4.9	-3.6		-0.1	1.3	
Non-interest current account deficit	**-1.0**	**-6.8**	**-6.2**	**1.5**	**5.6**	**-4.9**	**-4.2**	**-3.5**	**-2.2**	**-0.3**	**0.8**		**3.6**	**3.5**	3.7
Deficit in balance of goods and services	2.7	-4.7	-4.3			-2.1	-1.7	-1.2	0.2	2.1	3.2		4.8	3.6	
Exports	78.5	79.8	83.6			85.9	86.4	88.0	87.8	88.1	86.7		81.1	78.4	
Imports	81.1	75.1	79.3			83.8	84.7	86.8	88.1	90.2	89.9		85.9	82.0	
Net current transfers (negative = inflow)	-6.5	-5.3	-5.6	-6.5	0.9	-5.2	-4.9	-4.7	-4.4	-4.2	-4.0		-2.8	-0.8	-2.1
of which: official	-0.3	-0.2	-0.4			-0.3	-0.3	-0.2	-0.2	-0.2	-0.2		0.0	0.0	
Other current account flows (negative = net inflow)	2.8	3.2	3.6			2.4	2.3	2.3	2.0	1.9	1.7		1.5	0.8	
Net FDI (negative = inflow)	**-4.7**	**-4.5**	**-4.4**	**-4.7**	**2.0**	**-4.0**	**-3.9**	**-3.8**	**-3.7**	**-3.5**	**-3.4**		**-2.9**	**-1.7**	-2.5
Endogenous debt dynamics 2/	**-5.4**	**-4.4**	**-2.7**			**-1.2**	**-1.1**	**-1.1**	**-1.1**	**-1.1**	**-1.1**		**-0.7**	**-0.6**	
Contribution from nominal interest rate	0.8	0.8	0.7			0.7	0.8	0.9	1.0	1.0	1.1		1.0	0.4	
Contribution from real GDP growth	-2.0	-1.8	-1.9			-1.9	-2.0	-2.0	-2.1	-2.1	-2.2		-1.7	-1.0	
Contribution from price and exchange rate changes	-4.2	-3.5	-1.5			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**11.3**	**14.9**	**13.7**			**9.7**	**9.4**	**9.1**	**7.1**	**4.9**	**2.9**		**-1.3**	**-3.0**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	35.2			34.7	34.6	35.1	35.0	34.6	33.7		27.2	15.2	
In percent of exports	...	...	42.1			40.4	40.1	39.8	39.8	39.3	38.9		33.5	19.4	
PV of PPG external debt	**...**	**...**	**23.2**			**23.0**	**23.0**	**23.2**	**23.1**	**23.1**	**22.5**		**17.3**	**7.5**	
In percent of exports	**...**	**...**	**27.8**			**26.8**	**26.7**	**26.4**	**26.3**	**26.2**	**26.0**		**21.3**	**9.6**	
In percent of government revenues	**...**	**...**	**102.1**			**113.9**	**115.0**	**116.3**	**114.3**	**113.5**	**110.1**		**86.4**	**38.0**	
Debt service-to-exports ratio (in percent)	**3.6**	**3.7**	**2.8**			**3.1**	**2.9**	**2.9**	**3.0**	**3.5**	**3.7**		**3.8**	**2.6**	
PPG debt service-to-exports ratio (in percent)	**2.3**	**2.3**	**1.5**			**1.9**	**1.7**	**1.9**	**2.0**	**2.2**	**2.4**		**2.6**	**1.6**	
PPG debt service-to-revenue ratio (in percent)	**7.0**	**8.4**	**5.6**			**8.0**	**7.3**	**8.2**	**8.7**	**9.3**	**10.0**		**10.4**	**6.2**	
Total gross financing need (Billions of U.S. dollars)	2.5	-5.1	-5.0			-0.8	0.3	2.1	5.8	12.2	16.7		34.2	68.8	
Non-interest current account deficit that stabilizes debt ratio	-1.2	-6.0	-6.7			-4.5	-4.4	-4.2	-2.4	-0.2	1.6		5.0	5.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.2	5.2	5.4	6.4	0.9	5.5	5.6	5.7	5.8	5.9	6.0	5.7	5.5	5.5	5.6
GDP deflator in US dollar terms (change in percent)	12.3	9.8	4.0	9.0	6.2	4.4	3.1	1.5	2.9	2.4	2.5	2.8	2.5	2.4	2.6
Effective interest rate (percent) 5/	2.6	2.4	2.0	2.6	0.4	2.1	2.4	2.6	2.8	2.9	3.0	2.6	3.1	2.3	3.0
Growth of exports of G&S (US dollar terms, in percent)	32.5	17.6	14.9	20.4	11.9	13.1	9.6	9.2	8.7	8.8	7.0	9.4	7.6	5.0	7.6
Growth of imports of G&S (US dollar terms, in percent)	25.1	7.0	15.8	18.4	13.7	16.3	10.1	9.9	10.4	11.0	8.3	11.0	7.3	5.0	7.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	31.5	30.3	28.8	28.5	27.0	26.4	28.8	22.2	16.6	20.4
Government revenues (excluding grants, in percent of GDP)	25.4	22.3	22.8			20.2	20.0	20.0	20.3	20.3	20.5		20.0	19.8	19.9
Aid flows (in Billions of US dollars) 7/	7.7	7.0	5.3			4.1	4.2	4.5	5.1	5.1	5.0		4.2	3.4	
of which: Grants	0.6	0.5	0.2			0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.2	
of which: Concessional loans	7.1	6.6	5.0			3.8	4.0	4.2	4.9	4.8	4.8		4.0	3.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.1	1.1	1.1	1.1	1.0	0.9		0.5	0.2	0.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			34.1	32.6	30.9	30.3	28.6	28.2		24.0	18.2	22.1
Memorandum items:															
Nominal GDP (Billions of US dollars)	134.6	155.6	170.6			187.8	204.5	219.4	238.8	259.0	281.4		420.4	933.6	
Nominal dollar GDP growth	19.4	15.6	9.6			10.1	8.9	7.3	8.9	8.5	8.7	8.7	8.2	8.0	8.3
PV of PPG external debt (in Billions of US dollars)			39.5			42.6	46.4	50.4	54.8	59.2	62.8		72.0	69.7	
(PVt-PVt-1)/GDPt-1 (in percent)						1.9	2.0	1.9	2.0	1.9	1.4	1.8	0.3	-0.2	0.2
Gross workers' remittances (Billions of US dollars)	8.3	7.9	8.9			9.1	9.4	9.7	10.1	10.5	10.9		11.7	7.8	
PV of PPG external debt (in percent of GDP + remittances)	...	...	22.1			22.0	22.0	22.3	22.2	22.2	21.7		16.8	7.5	
PV of PPG external debt (in percent of exports + remittances)	...	...	26.2			25.4	25.3	25.1	25.1	25.1	24.9		20.6	9.5	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.4			1.8	1.6	1.8	1.9	2.1	2.3		2.5	1.6	

Sources: Vietnamese authorities; IMF estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Vietnam: Public Sector Debt Sustainability Framework, Baseline Scenario, 2011-34

(In percent of GDP, unless otherwise indicated)

	Actual					Projections									
	2011	2012	2013	Average 5/	Standard Deviation 5/	2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average
Public sector debt 1/	**46.7**	**48.5**	**51.6**			**54.7**	**56.9**	**59.1**	**60.0**	**60.7**	**60.7**		**58.2**	**48.4**	
of which: foreign-currency denominated	28.3	27.0	26.5			26.4	26.7	27.1	27.3	27.5	27.1		21.8	10.1	
Change in public sector debt	-1.6	1.8	3.1			3.1	2.2	2.2	1.0	0.7	-0.1		-0.6	-1.2	
Identified debt-creating flows	-5.0	1.3	2.6			2.9	1.2	1.4	-0.3	-0.6	-1.0		-1.3	-5.7	
Primary deficit	-0.1	5.3	4.1	1.4	2.4	4.9	4.5	3.9	3.0	2.3	2.0	3.4	1.6	-3.6	0.9
Revenue and grants	25.9	22.6	22.9			20.3	20.1	20.1	20.3	20.4	20.5		20.1	19.8	
of which: grants	0.4	0.3	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.0	0.0	
Primary (noninterest) expenditure	25.7	27.9	27.0			25.2	24.6	24.0	23.3	22.7	22.5		21.7	16.2	
Automatic debt dynamics	-7.8	-5.5	-2.8			-3.2	-3.6	-2.9	-3.6	-3.2	-3.3		-2.9	-2.1	
Contribution from interest rate/growth differential	-9.7	-5.2	-3.1			-4.0	-4.3	-3.5	-4.0	-3.6	-3.8		-3.3	-2.1	
of which: contribution from average real interest rate	-6.8	-2.9	-0.6			-1.3	-1.4	-0.4	-0.8	-0.3	-0.3		-0.3	0.5	
of which: contribution from real GDP growth	-2.8	-2.3	-2.5			-2.7	-2.9	-3.1	-3.2	-3.3	-3.4		-3.1	-2.6	
Contribution from real exchange rate depreciation	1.8	-0.2	0.3			0.7	0.7	0.6	0.5	0.5	0.5		...	...	
Other identified debt-creating flows	2.9	1.4	1.3			1.3	0.4	0.3	0.3	0.3	0.3		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	2.9	1.4	1.3			1.3	0.4	0.3	0.3	0.3	0.3		0.0	0.0	
Residual, including asset changes	3.4	0.5	0.5			0.1	0.9	0.8	1.2	1.3	1.0		0.7	4.5	
Other Sustainability Indicators															
PV of public sector debt	**...**	**...**	**48.4**			**51.3**	**53.3**	**55.2**	**55.9**	**56.3**	**56.1**		**53.7**	**45.8**	
of which: foreign-currency denominated	...	...	23.2			23.0	23.0	23.2	23.1	23.1	22.5		17.3	7.5	
of which: external	...	...	23.2			23.0	23.0	23.2	23.1	23.1	22.5		17.3	7.5	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	4.4	10.3	10.3			12.2	11.7	11.8	11.3	10.9	10.8		11.1	6.2	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	211.3			252.1	264.3	275.0	274.7	275.8	273.1		267.3	231.1	
PV of public sector debt-to-revenue ratio (in percent)	...	...	212.6			253.7	265.8	276.4	275.9	276.9	274.1		267.9	231.3	
of which: external 3/	...	...	102.1			113.9	115.0	116.3	114.3	113.5	110.1		86.4	38.0	
Debt service-to-revenue and grants ratio (in percent) 4/	16.3	21.9	22.5			30.1	30.7	33.6	34.7	35.9	36.8		40.6	41.5	
Debt service-to-revenue ratio (in percent) 4/	16.6	22.2	22.6			30.3	30.9	33.7	34.9	36.0	36.9		40.6	41.6	
Primary deficit that stabilizes the debt-to-GDP ratio	1.5	3.5	1.0			1.8	2.3	1.7	2.0	1.6	2.0		2.2	-2.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.2	5.2	5.4	6.4	0.9	5.5	5.6	5.7	5.8	5.9	6.0	5.7	5.5	5.5	5.6
Average nominal interest rate on forex debt (in percent)	2.6	2.5	1.9	2.3	0.2	2.1	2.2	2.4	2.6	2.8	3.1	2.5	3.1	1.6	2.9
Average real interest rate on domestic debt (in percent)	-14.4	-4.8	0.5	-6.1	5.0	-1.1	-1.8	0.2	-0.6	0.2	0.1	-0.5	0.1	1.6	0.3
Real exchange rate depreciation (in percent, + indicates depreciation)	7.9	-1.0	1.3	3.1	3.6	3.0	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	21.3	10.9	4.8	12.3	6.2	6.4	6.2	4.2	5.1	4.3	4.4	5.1	4.5	4.4	4.6
Growth of real primary spending (deflated by GDP deflator, in percent)	-4.7	14.2	1.9	1.2	4.9	-1.4	3.1	3.1	2.8	3.0	5.0	2.6	4.7	-4.5	3.4
Grant element of new external borrowing (in percent)	...	...	...	...	...	31.5	30.3	28.8	28.5	27.0	26.4	28.8	22.2	16.6	...

Source: Vietnamese authorities; and IMF staff estimates and projections.
1/ General government gross debt.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

INTERNATIONAL MONETARY FUND

VIETNAM

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 15, 2014

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of May 31, 2014)

Membership Status

Joined: September 21, 1956; Article VIII

General Resources Account

	SDR Million	Percent of Quota
Quota	460.70	100.00
Fund holdings of currency	460.70	100.00
Reserve position in Fund	0.01	0.00

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	314.79	100.00
Holdings	268.01	85.14

Outstanding Purchases and Loans: None

Latest Financial Arrangements

In millions of SDRs (mm/dd/yyyy)

Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
ECF[1]	04/13/2001	04/12/2004	290.00	124.20
ECF[1]	11/11/1994	11/10/1997	362.40	241.60
Stand-By	10/06/1993	11/11/1994	145.00	108.80

[1] Formally PRGF.

Projected Payments to Fund

In millions of SDRs (based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/interest	0.02	0.05	0.05	0.05	0.05
Total	**0.02**	**0.05**	**0.05**	**0.05**	**0.05**

Exchange Arrangement

The exchange rate arrangement is classified as "stabilized." The de jure arrangement is managed floating. The State Bank of Vietnam (SBV) announced a 1 percent devaluation of the dong (VND) on June 18, 2014 and maintained the trading band at ±1 percent.

Vietnam maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for those exchange restrictions imposed for security reasons of which Vietnam has notified the IMF pursuant to Executive Board Decision No. 144-(52/51), 8/14/52.

Article IV Consultations

Vietnam is on a 12-month consultation cycle. The last Article IV consultation was held in Hanoi during April 8–25, 2013, and was concluded by the Executive Board on June 24, 2013 (Public Information Notice No. 13/304).

Technical Assistance

In recent years, Vietnam has received extensive technical assistance (TA) in the areas of tax policy and administration, public financial management, statistics (government finance, external sector, price, and national accounts), financial soundness indicators, stress testing the banking sector, and monetary operations and liquidity management. From December 2008 to January 2012, a resident advisor assisted the authorities in improving banking supervision. The IMF-World Bank Financial Sector Assessment Program was undertaken during 2012–13.

Resident Representative

Mr. Sanjay Kalra is the Resident Representative for Vietnam and Lao P.D.R., based in Hanoi.

RELATIONS AND COLLABORATION WITH THE WORLD BANK GROUP[1]

(As of June 18, 2014)

Partnership in Vietnam's Development Strategy

The World Bank Country Partnership Strategy (CPS) for Vietnam was presented to the Board of Directors in December 2011. The CPS is aligned with Vietnam's Socio-Economic Development Strategy (SEDS) 2011–15 and sets out the World Bank's planned support for Vietnam between FY12 and FY16. The CPS program supports investments and policies organized into a strategic framework of three pillars and three cross-cutting themes. The pillars are: (i) strengthening Vietnam's competitiveness in the regional and global economy, (ii) increasing the sustainability of its development, and (iii) broadening access to opportunity. Key cross-cutting themes are: (i) strengthening governance; (ii) supporting gender equity; and (iii) improving resilience in the face of external economic shocks, natural hazards, and the impact of climate change.

An underlying theme in the CPS is the importance of building on the country's strong track record of growth and poverty reduction to partner with Vietnam in its effort to achieve success as a middle-income country (MIC). The CPS program supports reforms for Vietnam's multiple transitions, notably, from an agrarian economy toward one that is more urban and industrialized; from a focus on quantity toward a greater focus on quality of production and service provision; and from a factor driven to an efficiency driven economy.

World Bank Group Strategy and Lending

The World Bank Group uses a broad range of instruments including development policy loans, program for results (PforR) and investment operations, and analytical and advisory activities; the IFC's equity, loan, and technical assistance (TA) participations and the Mekong Private Sector Development Facility (MPDF); Multilateral Investment Guarantee Agency (MIGA) activities; and donor partnerships and ODA coordination.

Scale of the World Bank Group program: The WB Portfolio is large, with a significant IDA16 Allocation amounting to US$4.37 billion. The program has grown and diversified over the past several years. As of June 9, 2014, the portfolio consisted of 50 IDA/IBRD operations and six stand-alone Global Environment Facility (GEF), Chlorofluorocarbon (CFC), and large Recipient Executed Trust Funds (RETF) projects, with the total net commitments of US$9.7 billion. Vietnam became an IDA/IBRD blend country in FY10. So far, IBRD resources of US$1.9 billion have been used to finance two DPO series, an expressway, a transmission and distribution project, and a hydro-power project.

[1] Questions may be referred to Ms. Williams (202-473-6997).

International Finance Corporation (IFC) commitments totaled US$2,597 million over the five-year period of FY11–FY13, including mobilization through its asset management business and commercial banks, and commitments for FY14 is expected to surpass US$1 billion.

Lending program: The World Bank has a diverse lending program supporting infrastructure, rural development, human resources, and improvement in economic and financial sector management. Support to infrastructure includes energy supply and distribution, rural and national road development, water and wastewater treatment, irrigation systems rehabilitation, and natural resources management. For rural water and sanitation, the first PforR operation was approved in support of Vietnam's National Targeted Program in FY13. A second PforR was approved by the Board for National Urban Program in early June this year. The program also supports development of health systems to ensure increased access to quality health services and education quality improvements. Key elements of economic management support include a multi-year development policy loan linked to reforms on economic management and competitiveness, tax system reform, and development and modernization of public financial management and financial systems.

Knowledge program: The World Bank supports the government's efforts to strengthen institutional capacity through its extensive knowledge program of analytical and advisory services. While financing is still an important part of the partnership between the Vietnamese government and the World Bank, Vietnam's new status as a MIC highlights the important role the Bank can and does play in generating knowledge and sharing global experiences and best practice. The annual Vietnam Development Reports (VDRs) summarize the accumulated knowledge in a specific policy area of Vietnam's reform agenda. Recent VDRs have focused on thematic areas such as skills development, Vietnam's transition to a market economy, natural resource management, and modern institutions. The 2015 VDR will focus on long-term growth and competitiveness.

Other reports during this period have included a Fiscal Transparency Review, a Poverty Assessment, a report on Trade Facilitation, Value Creation, and Competitiveness, and an Urbanization Review. Forthcoming reports cover the topics of Fiscal Decentralization, Public Expenditure Review, and Conflict of Interest. In addition, the World Bank continues to provide technical assistance in areas such as governance, social protection, renewable energy, climate change adaptation, financial sector reform, and public financial management reform.

IMF-World Bank Collaboration in Vietnam

Specific Areas: Since the expiration of the PRGF in April 2004, the two institutions have closely collaborated on monitoring the macroeconomic situation, and in discussions of PRSC triggers and benchmarks in the policy areas that used to be covered by the PRGF agreement. The IMF has provided assessment letters in support of PRSC and EMCC operations. In the area of public financial management, the World Bank recently closed an investment credit to support the introduction of a modern Treasury and Budget Management Information System, and a large multi-donor trust fund to provide technical advice for public financial management reform. It also has an investment loan for Tax Administration Modernization. The World Bank is preparing a Programmatic Public Finance

Review (PPFR), and collaborates closely on this with the IMF. There is close cooperation between the IMF's Regional PFM Advisor and the Bank team in Hanoi.

In recent years, joint work has been carried out to support the establishment of a modern central bank, with the IMF providing TA on monetary policy and operations, and both the World Bank and IMF providing TA on banking supervision. The World Bank has also set up investment credits to support development of an integrated system of advanced business processes and modern information technology at the SBV (including for the Deposit Insurance Agency and Credit Information Center) to improve its capacity to make more informed and timely policy decisions. The IMF and World Bank conducted Vietnam's first joint Financial Sector Assessment Program (FSAP) during 2012–13. Since 2005, the World Bank and the IMF have jointly prepared an annual Debt Sustainability Assessment. The Asian Development Bank has joined since 2009. Training to the authorities on debt management is ongoing. There has been close coordination with the Fiscal Affairs Department on tax policy and administration issues, including the recent amendments to the Laws on Corporate Income Tax and Value Added Tax. The IMF and the World Bank also collaborate in the development and timely dissemination of reliable economic and financial statistics. The IMF focuses on improving balance of payments, national accounts, price, and government finance statistics, while the World Bank provides assistance on issues related to the production of high-quality household and enterprise surveys and facilitate the implementation of National Gender Indicators System. The two institutions consult during Article IV consultations in order to share information and help coordinate policies.

World Bank Lending Program for FY12–14

(As of December 1, 2013)

	Vietnam Operation	IBRD $m	IDA $m	Total (IBRD+IDA)
	IDA16 Vietnam Allocation in SDRs		2,759.0	
FY12				
1	Third Rural Transport Project - Additional Financing		97.0	97.0
2	Medium Cities Development Project		210.0	210.0
3	Vietnam Poverty Reduction Support Credit 10		150.0	150.0
4	Vietnam Climate Change Development Policy		70.0	70.0
5	Mekong Delta Region Urban Upgrading Project		292.0	292.0
6	Forest Sector Development Project - Additional Financing		30.0	30.0
7	Vietnam Power Sector Reform DPO2	100.0	100.0	200.0
8	Coastal Resources for Sustainable Development Project		100.0	100.0
	Total FY12 Projects	100.0	1,049.0	1,149.0
FY13				
1	Vietnam - Managing Natural Hazards Project		150.0	150.0
2	Distribution Efficiency Project		448.9	448.9
3	Vietnam Climate Change Development Policy 2		70.0	70.0
4	Vietnam Industrial Pollution Management Project		50.0	50.0
5	VN-Rural Sanitation & Water Supply (P4R)		200.0	200.0
6	Mekong Transport Infrastructure Development - AF		156.0	156.0
7	Higher Education Development Policy Program - Third Operation		50.0	50.0
8	Vietnam School Readiness Promotion Project		100.0	100.0
9	Economic Management Competitiveness Credit 1 (EMCC1)		250.0	250.0
10	Danang Sustainable City Development Project (SCDP)		203.0	203.0
11	Vietnam Inclusive Innovation Project		55.0	55.0
12	North East and Red River Delta Regional Health System Support Project (NORRED)		150.0	150.0
13	Vietnam Science and Technology Innovation - FIRST (Fostering Innovation through Research, Science and Technology)		100.0	100.0
	Total FY13 Projects	--	1,982.9	1,982.9
FY14 Plan				
1	Regional Mekong Water Resources		25.0	25.0
2	Vietnam Irrigation Efficiency Project		180.0	180.0
3	VN-Poverty Reduction in Central Highlands		150.0	150.0
4	Power DPO 3	200.0		200.0
5	EMCC2		250.0	250.0
6	Vietnam Social Protection System		60.0	60.0
7	Vietnam Road Asset Management Project		250.0	250.0
8	Vietnam Health Human Resources Strengthening Project		106.0	106.0
9	Northern Mountainous Urban Development Project PforR		250.0	250.0
10	Climate Change DPO3		70.0	70.0
	Planned Total FY14 Projects*	200.0	1,341.0	1,541.0
	Total IDA16	300.0	4,372.9	4,672.9

* Regional Mekong Water Resources project will use only $8 million from the country allocation.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of July 2014)

The Asian Development Bank (ADB) has been working in partnership with the Government of Vietnam—a 1966 founding member of ADB—since the resumption of operations in 1993.

ADB's Country Partnership Strategy (CPS), 2012–2015 is fully aligned with the Socio-Economic Development Plan (SEDP), 2011–2015, and supports issues arising from Vietnam's recent transition to a middle-income country. The CPS focuses ADB assistance to Vietnam through three pillars of inclusive growth, enhancing economic efficiency, and environmental sustainability. To maximize ADB's development impacts, ADB prioritizes six sectors: (i) agriculture and natural resources; (ii) education; (iii) energy; (iv) finance; (v) transport; and (vi) water supply, and other municipal infrastructure and services. Public sector management is crosscutting and mainstreamed in terms of sector operations through reform and policy-oriented support.

ADB is supporting the implementation of structural reforms that increase competitiveness and assist Vietnam in transitioning to a middle-income country. ADB is engaged in policy dialogue on financial sector and state-owned enterprise (SOE) reforms. To facilitate faster development of infrastructure, ADB is assisting the government to develop a pilot scheme to promote public–private partnerships.

Vietnam is one of the largest concessional Asian Development Fund (ADF) recipients, with projected ADF allocation of US$732 million for 2013–14. Ordinary capital resources (OCR) are also actively being used for projects with higher rates of return, such as infrastructure, which had an average allocation of US$835 million during 2009–13 (Table 1).

Table 1. Lending (Approved Amount)* and Disbursement by Year, 1993-2013
(In millions of U.S.dollars)

	Approved Amount[1/]			Disbursement
Year	Ordinary Capital Resources	Asian Development Fund	Total	Total
1993	-	262	262	0
1994	-	140	140	3
1995	-	233	233	48
1996	-	303	303	29
1997	-	360	360	149
1998	-	284	284	128
1999	40	180	220	191
2000	-	189	189	219
2001	-	243	243	176
2002	-	234	234	232
2003	-	179	179	233
2004	120	176	296	182
2005	360	218	578	224
2006	-	308	308	184
2007	924	515	1439	230
2008	606	159	765	265
2009 2/	1,403	523	1,926	1,093
2010	510	580	1,090	407
2011	1,031	365	1,396	792
2012	822	463	1,285	623
2013	410	365	775	1,226

Source: Asian Development Bank.

1/ Includes loan components of regional projects in Vietnam.

2/ Excludes a guarantee of $325 million for EVN (Loan No. 2604, approved on 12/11/09).

From October 1993 until December 31, 2013, ADB has provided 133 sovereign loans totaling US$12.5 billion, 280 technical assistance grant projects amounting to US$258.3 million and 31 grant projects totaling US$305 million to Vietnam (Tables 2–4).

As a catalyst for private investments, ADB also provides direct financial assistance to nonsovereign public sector and private sector projects in the form of direct loans, equity investments, guarantees, B loans, and trade finance. Since its inception to end-2013, ADB has approved a total of US$280 million in non-sovereign financing for Vietnam, all of which was for seven private sector projects. Total outstanding balances and commitments of ADB's private sector transactions in the country as of December 31, 2013 totaled about US$169.7 million, representing 4.6 percent of ADB's total nonsovereign portfolio.

ADB's Trade Finance Program (TFP) fills market gaps in trade finance by providing guarantees and loans through over 200 partner banks in support of trade. The TFP has supported US$16 billion in trade involving almost 6,500 small and medium-sized enterprises. In Vietnam, the TFP works with nine banks and has supported over US$4.7 billion in trade between 3,200 transactions by almost 2,000 small- and medium-sized enterprises. In addition to filling market gaps, the TFP's objective is to mobilize private sector capital/ involvement in developing Asia. In Vietnam, over 69 percent of the US$3.6 billion in trade supported through the TFP was co-financed by the private sector.

Vietnam also receives substantial support under the Greater Mekong Sub-region initiatives, involving Cambodia, China, Lao P.D.R., Myanmar, Thailand, and Vietnam.

As part of its regular operations, ADB coordinates closely with Vietnam's development partners to improve the effectiveness, efficiency, and impact of its lending and non lending programs. ADB also works closely with civil society organizations and the private sector in Vietnam to mobilize financial resources and expertise from other partners. ADB is an active member of the Aid Effectiveness Forum and the Six Banks Initiative—comprising ADB, Agence Française de Développement (AFD), KfW, Japan International Cooperation Agency, Export Import Bank of Korea, and the World Bank.

Co-financing operations enable ADB's financing partners, governments or their agencies, multilateral financing institutions, and commercial organizations, to participate in the financing of ADB projects. The additional funds are provided in the form of official loans and grants, and commercial financing, such as B loans, risk transfer arrangements, parallel loans, and co-financing for transactions under ADB's TFP. As of December 31, 2013, cumulative direct value-added official co-financing for Vietnam amounted to US$3.65 billion for 46 investment projects and US$95.6 million for 76 co-financing technical assistance projects.

The ADB and IMF staffs coordinate through ad hoc information exchange information on policy matters.

Table 2. Technical Assistance by Sector, December 2013

Sector	Number of Projects	In millions of U.S. Dollars	In Percent of Total
Agriculture and Natural Resources	49.0	48.4	18.7
Education	19.0	12.7	4.9
Energy	37.0	31.0	12.0
Finance	33.0	20.3	7.9
Health and Social Protection	14.0	6.9	2.7
Industry and Trade	8.0	12.6	4.9
Multi-sector	2.0	3.2	1.2
Public Sector Management	62.0	39.6	15.3
Transport and ICT	31.0	60.3	23.4
Water and Other Municipal Infrastructure and Services	25.0	23.3	9.0
Total	280.0	258.3	100.0

Source: Asian Development Bank.

Table 3. Loans by Sector, December 2013

Sector	Number of Loans	In Millions of U.S. Dollars	In Percent of Total
Agriculture and natural resources	27.0	1,660.2	13.3
Education	14.0	733.0	5.9
Energy	11.0	2,478.3	19.8
Finance	11.0	605.0	4.8
Health and social protection	8.0	343.2	2.7
Industry and trade	5.0	109.5	0.9
Multi-sector	7.0	280.0	2.2
Public sector management	13.0	1,029.1	8.2
Transport and ICT	24.0	4,145.7	33.2
Water and other municipal infrastructure and services	13.0	1,119.2	9.0
Total	133.0	12,503.1	100.0

Source: Asian Development Bank.

Table 4. Grants by Sector, December 2013

Sector	Number of Grants	In Millions of U.S. Dollars	In Percent of Total
Agriculture and natural resources	10.0	53.6	17.6
Education	2.0	2.8	0.9
Finance	1.0	1.5	0.5
Health	8.0	56.1	18.4
Multi-sector	3.0	15.0	4.9
Transport and ICT	4.0	172.0	56.4
Water and other municipal infrastructure and services	3.0	4.0	1.3
Total	31.0	305.0	100.0

Source: Asian Development Bank.

STATISTICAL ISSUES

(As of May 6, 2014)

Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings, but is broadly adequate for surveillance. Most affected areas are: financial sector, national accounts, government finance, and external sector statistics.

National accounts: The General Statistics Office (GSO) provides quarterly (cumulative) and annual data on GDP by type of economic activity and annual data by expenditure (both in current and constant prices), and monthly and annual data on external trade, industrial output, retail sales, and prices. The GSO recently rebased the national accounts to 2010 as the base year from 1994. While the national accounts methodologies are broadly consistent with the *SNA93*, the data collection practices and coordination between data collection agencies could be strengthened. A recent National Accounts technical assistance mission made the following recommendations: (i) adoption of labor input methods to improve the coverage of the nonobserved economy, (ii) estimation of capital stock, consumption of fixed capital and change in inventories, (iii) allocation of financial intermediation services indirectly measured (FISIM), (iv) expansion of production and asset boundaries according to 1993/2008 SNA, (v) use of the supply-use framework to ensure consistency between production and expenditure GDP data, and (vi) the use of double deflation methods for constant price estimates.

Prices statistics: The CPI methodology is largely in line with international standards. However, there is only a notional inclusion of owner-occupied and rental housing. Also, there is a need to adopt a geometric mean of price relatives at the lower level of aggregation, instead of the upward biased arithmetic mean. Trade price indices are also compiled, but not used in the national accounts. The GSO has developed a work program with assistance of Fund TA to improve the accuracy of the consumer, producer and trade price indices, and is working toward the development of construction and services price indices.

Government finance statistics: Government operations data reflect the consolidated operations of the state budget, which cover all four levels of government (central, provincial, district, and commune). However, data exclude quasi fiscal activities of the central bank (and state-owned enterprises (SOEs)), and extra-budgetary funds, among which are the Social Security Fund, Enterprise Restructuring Fund, Development Assistance Fund, Export Support Fund, local development funds, and the Sinking Fund (for repayment of on-lent funds), for which data are not compiled/disseminated on a regular basis. Compilation is on a cash basis for final annual data, but varies for provisional data depending on their source. As a result, government financing data, in particular domestic bank financing, cannot be reconciled as reported in the fiscal and monetary accounts. The World Bank and the IMF have recommended improving the coverage of fiscal data and aligning definitions with the *GFSM 2001*. Vietnam tentatively confirmed participation in the three-year GFS technical assistance (TA) project for Asia and Pacific Island countries, funded by the Japanese government. Participation in this project, launched recently by STA, could enhance further the quality of fiscal data.

Monetary statistics: The IMF's Statistics Department (STA) has encouraged the State Bank of Vietnam (SBV) to develop a reporting scheme for a comprehensive break-down of banks' credit to the economy by borrowing sectors and subsectors. In addition, STA has recommended that: (a) a list of SOEs that have been privatized and, therefore, should be classified as private enterprises should be distributed to banks in order to guide their data reporting on enterprises; (b) funds for on-lending should be reclassified out of banks' "unclassified liabilities" to "other deposits."

External sector statistics: Balance of payments statistics rely on limited source data, resulting in gaps in several areas of the external accounts (current, capital, and financial). The authorities are working on improving data on tourism revenue (travel) and workers' remittances, supported by IMF's STA TA. STA technical assistance missions have made the following observations and recommendations: (i) the available resources are not sufficient to ensure effective implementation of an International Transaction Reporting System; (ii) further improvements are still needed in the treatment of goods for processing in line with BPM6, improvement of remittances estimates, and further study on unrecorded trade in gold; (iii) to establish a uniform concept of direct investment (DI) in the national legislation and develop a reliable data source on DI stocks (at present DI data are based on regulatory approvals) given that it is an important component of the International Investment Position; (iv) address significant errors and omissions in the balance of payments, which could be related to underestimation of DI flows and estimates of changes in household holdings of foreign exchange in cash; (v) international reserves transactions need to be distinguished from valuation changes; (vi) dissemination of external sector statistics, in line with internationally accepted practices.

Financial sector statistics: The availability of data on the financial sector is very limited, and the quality of data requires substantial improvement, even on key financial soundness indicators.

Data Standards and Quality

Vietnam is a participant in the General Data Dissemination System (GDDS) since September 2003. In conjunction with the authorities, staff from STA have developed a roadmap for Vietnam's eventual subscription to the Special Data Dissemination Standard (SDDS).

No data ROSC are available.

Reporting to STA

Currently, no government finance statistics (GFS) are reported for publication in the IMF's *Government Finance Statistics Yearbook (GSY)* or *International Financial Statistics (IFS)*. Annual GFS data through 2004, excluding extra-budgetary funds and social security funds, based on the 1986 GFS format, have been reported for publication in the *GFSY*. No sub-annual fiscal data have been reported for publication in *IFS* since 2001.

Table of Common Indicators Required for Surveillance

(As of May 6, 2014)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	May 2014	5/6/14	D	I	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Feb. 2014	5/6/14	M	M	N/A
Reserve/Base Money	Jan. 2014	4/3/14	M	I	N/A
Broad Money	Jan. 2014	4/3/14	M	I	N/A
Central Bank Balance Sheet	Jan. 2014	4/3/14	M	I	N/A
Consolidated Balance Sheet of the Banking System	Jan. 2014	4/3/14	M	I	N/A
Interest Rates[3]	Oct. 2013	1/15/14	M	I	N/A
Consumer Price Index	Apr. 2014	4/24/14	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	...	...	...	...	N/A
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	Apr. 2014	Apr. 2014	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Dec. 2013	Mar. 2014	A	A	A
External Current Account Balance	Q4 2013	4/15/14	Q	Q	Q
Exports and Imports of Goods and Services[7]	Mar. 2014	4/7/14	M	M	M
GDP/GNP	Q1 2014	3/25/14	Q	Q	Q
Gross External Debt	2013	Mar. 2014	A	A	A
International Investment Position[8]	...	...	N/A	N/A	N/A

[1]Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); and Not Available (N/A).

[2]Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency, but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[3]Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[4]Foreign, domestic bank, and domestic nonbank financing.

[5]The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

[6]Including currency and maturity composition.

[7]Services data available on an annual basis.

[8]Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Statement by Mr. Abdul Ghaffour, Alternate Executive Director and Ms. Nguyen, Advisor to the Executive Director On Vietnam Staff Report for the 2014 Article IV Consultation

1. Our authorities highly appreciate the candid and constructive discussions on macroeconomic developments and policy issues in Vietnam during the 2014 Article IV Consultation of the IMF mission led by Mr. John Nelmes. Our authorities broadly agree with staff's assessment and main policy recommendations. Achievements of containing inflation, preserving macro stability, and accelerating SOEs and banking sector reforms, whilst ensuring sustainable economic growth and social security of Vietnam have been well acknowledged by the Staff. The useful advice rendered during the Article IV Consultation should be reflected upon and considered in the authorities' development plan. In this statement, we will elaborate our view on some key areas.

Economic Developments

2. **Despite challenging global environment and domestic difficulties, with great efforts of Vietnam government, the economy continues to gain commendable achievements in macroeconomic stabilization and inflation containment, with accelerating GDP growth**. These positive developments have contributed to record high international reserves of more than USD36 billion as at the end of May 2014, equivalent to around 12 weeks of prospective imports of goods and services, and expected to be built up further.

Monetary, exchange rate and credit policies

3. **Exchange rate policy is flexibly managed in line with other monetary instruments in order to stabilize the market.** Given low inflation for the first five months of 2014 and stable exchange rates for a long time, the SBV proactively depreciated the VND by 100 bps on June 19, 2014 to promote economic activities. The market quickly restores its stability and the VND has been appreciated recently that facilitates the SBV to continue to buy USD from the market to increase its international reserves.

4. **Liquidity in the banking system is ample that facilitates banking sector reforms.** It appears that banks would like to provide credit to customers while also focus on improving credit quality and safety in banking system operations. In addition, although credit growth is low due to weak domestic demand as well as difficulties in the economy, credit policy has been conducted in a flexible manner including lending in foreign currency and channeling credit to prioritized sectors.

Fiscal Policy

5. **The authorities view fiscal consolidation as a crucial element to ensure fiscal sustainability in the long run and commit towards fiscal consolidation**. The recent difficult external and domestic conditions have had adverse impacts on businesses, especially domestic enterprises. To provide some breathing space for businesses, the Government allowed reductions, deferrals, and exemptions in certain types of taxes and revenue that will foster economic development and increase budget revenue in the long run. In addition, budget expenditure will continue to be tightened. To ease pressure on budget spending and enhance public service efficiency, the

Government plans to reduce the size of public service staff in the next few years and delays the planned roadmap of public salary increase. We share the Staff recommendation that fiscal consolidation should protect social spending and investment and makes space for potential NPL resolutions and banks recapitalization.

6. **Public investment reform has always been an important agenda of the authorities.** The revised Public Investment Law was adopted by the National Assembly in 2014 to enhance the efficiency of public investment activities, and greater use of public-private partnership.

Financial Sector Reform

7. **The Government and the SBV have proposed comprehensive and synchronous measures to solve the root cause of the system's weaknesses.** As a result, the credit institution (CI) restructuring has gained significant progresses and the financial condition of the banking system has made improvements. We share the IMF's recommendation that there needs to be a comprehensive reform package to promote the banking reform process and NPL resolution, especially to allocate state budget for those activites and accelerate legal reform.

8. **While we find the IMF's recommendation to push ahead with further banking sector reform and NPL resolution are plausible, significant progresses have been made regarding banking governance and supervision as well as legal framework for banking sector in Vietnam.** The risk-based supervision has been improved following the SBV's Action plan for the implementation of 2011-2015 Banking Restructuring Plan. In addition, all banks are required to submit their operational and financial restructuring plans for approval of the SBV.

9. **NPL resolution has also achieved positive outcomes given the constraints of budgetary resources and legal reforms.** The VAMC initially appears to be effective in curbing and resolving NPLs. A large portion of NPLs has been removed from the system. To accommodate the VAMC's enlarged operations, its chartered capital will be tripled by end-2014.

10. **Legal framework on loan classification and provisioning has been improved.** Circular 02 was effective from June 1, 2014. However, due to the slow pace of recovery of the Vietnamese economy, we believe that the full implementation of Circular 02 would have great impacts on the banking system, especially on restricting credit expansion and accessibility. Therefore, to support the economic activities, the authorities issued Circular 09 that amend and supplement some articles of Circular 02 by allowing loan rescheduling without reclassification from 20 March 2014 to 31 March 2015 subject to ***very rigorous conditions***, such as: (i) loan rescheduling can only be undertaken once during the term of the loan; (ii) customers have to provide a feasible repayment plan in line with the purpose of the borrowing in the credit contract, production and business conditions, satisfying prudential ratios and limitation requirements; (iii) CIs have to issue internal regulations to strictly control and supervise the loans and periodically report to the SBV; and (iv) CIs have to maintain loan classification based on consolidated results from the Credit Information Center.

SOE Reforms

11. **Although facing many challenges, we see that the authorities have made great efforts in supporting SOE restructuring, and believe significant reform progresses can be achieved**

by end-2015. Restructuring plans have been developed, and efforts are focused on amendments to the legal framework by issuing new regulations to enhance SOEs' financial reporting and transparency, improve internal controls and corporate governance, and support SOEs in equitization and divesting from non-core businesses, such as Resolution No. 15/NQ-CP, Land Law 2013 and Bankruptcy Law 2014. That would facilitate to remove constraints on bankruptcy proceedings, help VAMC timely handle debts and mortgaged assets, and contribute to speeding up NPL resolution.

Concluding Remarks

While Vietnam will continue to implement its reform agenda to take full advantage of the country's growth prospects within the growing Asian region, they are mindful of considerable challenges ahead and realize that sustainable results would take time to materialize. We share the full commitment and determination of the authorities towards undertaking necessary restructuring measures and policies to help improve the investment climate and sustain economic growth, while providing buffers against external and domestic shocks. These efforts need to be supplemented by support from multilateral institutions and other countries.