



International Finance

# INFLATION PRESSURE IN VIETNAM'S ECONOMY

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# Agenda

1. Inflation definition
  2. Vietnam's economy overview
  3. Inflation in Vietnam's economy
    - The causes
    - **Pressures**
    - Solutions to reduce inflation
    - Positive aspects
  4. Outlook of Vietnam's economy in 2009 Q1
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# 1. Inflation definition

❑ Inflation is defined as a sustained increase in the general level of prices for goods and services. It is measured as an annual percentage increase. As inflation rises, every dollar you own buys a smaller percentage of a good or service.

❑ “Inflation is when you pay fifteen dollars for the ten dollar haircut you used to get for five dollars when you had hair” (Sam Ewing, American writer)

## **There are several variations on inflation:**

❑ Deflation is when the general level of prices is falling. This is the opposite of inflation.

❑ Hyperinflation is unusually rapid inflation. In extreme cases, this can lead to the breakdown of a nation's monetary system. One of the most notable examples of hyperinflation occurred in Germany in 1923, when prices rose 2,500% in one month!

❑ Stagflation is the combination of high unemployment and economic stagnation with inflation. This happened in industrialized countries during the 1970s, when a bad economy was combined with OPEC raising oil prices.

In recent years, most developed countries have attempted to sustain an inflation rate of 2-3%.

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## 2. Vietnam's economy overview

- ❑ GDP: Economic growth slowed down significantly, to just about 6.2% from 8,5% in 2007. 2009 forecast: 5%
  - ❑ Export grows faster, by 29.5% in 2008 (2007: 21.9%), due to increases in international prices. But export worsens since 4th quarter of 2008.
  - ❑ Import continues to rise, (2008: 28.3%; 2007: 35.5%).
  - ❑ Current acc. in massive deficit (2008: USD 11.5 billion, 13.6% GDP), largely due to merchandise trade deficit (USD 14.6 billion, 15.9%).
  - ❑ Capital acc. rose rapidly, due to high disbursement of FDI, ODA, indirect investment → BOP in surplus, but not sustainable
  - ❑ Budget revenue increased, despite tariff cuts (due to higher tax base). Yet uncertainty remains, due to high reliance on revenues from trade and crude oil
  - ❑ Budget deficit decreased to 4.95% in 2008, but will be under lots of pressures (due to possible fall in revenues, and demand-stimulus policy package).
  - ❑ **CPI inflation: Very high in first 8 months (in 8/2008, yoy inflation: 28.3%, or 16.5% after eliminating prices of food-foodstuffs). Since 9/2008, month-to-month CPI inflation dropped to negative levels. CPI inflation of 2008: 24%**
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## 2. Vietnam's economy overview

(USD billions)	2004	2005	2006	2007	2008	2009 (f)
Economic growth (%)	7,8	8,4	8,2	8,5	6,2	5
Inflation (%)	7,7	8,3	7,5	8,3	24	12
Public sector balance (%GDP)	-3,3	-4,1	-2,9	-5,4	-4,7	-6,8
Exports	26,5	32,4	39,8	48,6	62	49,3
Imports	28,8	34,9	42,6	58,9	76,6	60
Trade balance	-2,3	-2,4	-2,8	-10,3	-14,6	-10,7
Current account balance	-0,9	-0,5	-0,2	-7	-11,5	-7,6
Current account balance	-2,00%	-1,00%	-0,30%	-9,80%	-13,60%	-8,10%
Foreign debt (%GDP)	39,6	36,3	33,2	30,7	27,4	23,6
Debt service (%Exports)	5,30%	5,20%	4,80%	4,70%	4,70%	6,00%
Foreign currency reserves (in	2,2	2,5	3,2	4	2,9	4,4

(Prof. Dr. MICHEL HENRY BOUCHET)

# 3. Inflation in Vietnam's economy: The causes

## Demand-Pull Inflation

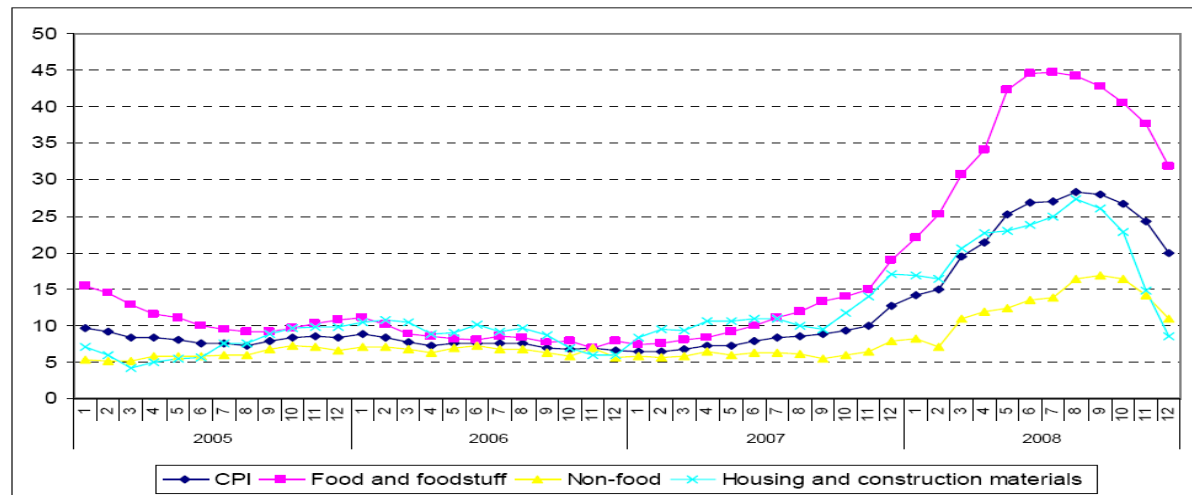
- ❑ Expansionary macroeconomic policy in many years (credit expansion), economy is ever-heating.
- ❑ Too much lending, there's been too much government spending, basically, too much cash sloshing → a party out of control.
- ❑ Huge surge in FDI inflows → rapid increase in FDI share in investment. Slower CPI inflation in late 2008 due to tightening macro policy and “good luck” (lower international prices of rice and energy)

## Cost-Push Inflation

- ❑ Rising international prices: Oil, steel, medicine...
- ❑ Food - foodstuff price problems.

## Weak macroeconomic regulation/adjustment from Gov.

## Consumer psychology



## 3. Inflation in Vietnam's economy: Pressures

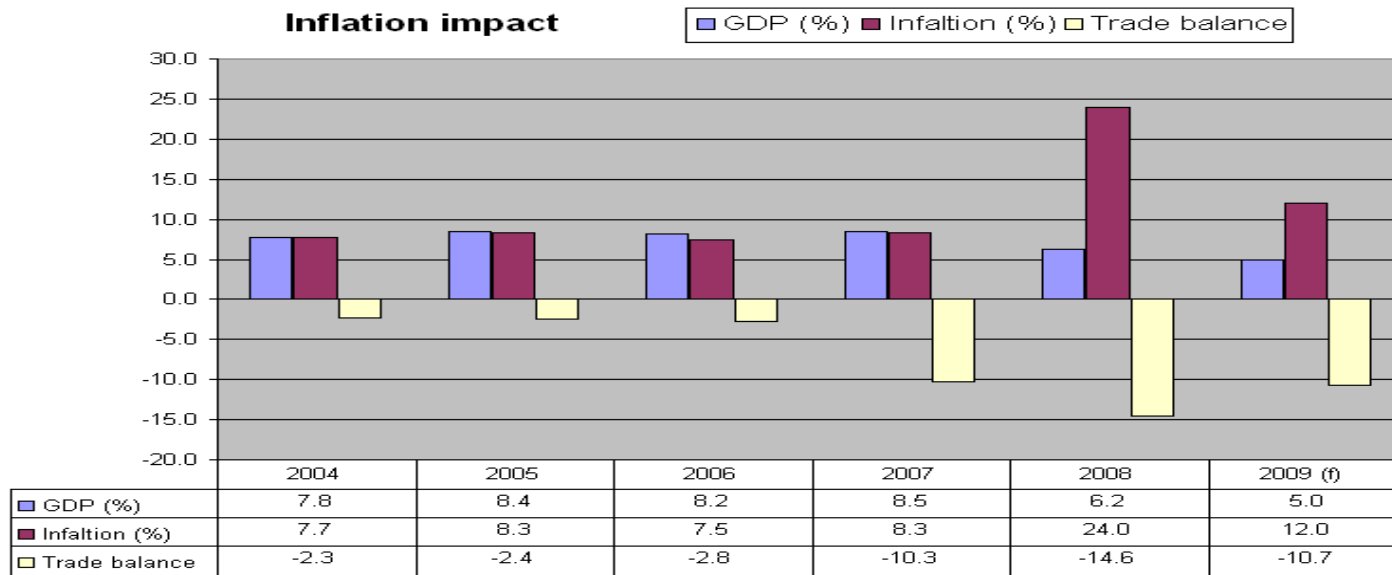
1. Growth, trade, and investment
  2. Labor and social issues
  3. Risks in currency system
  4. Pressures on firms
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# 3. Inflation in Vietnam's economy: Pressure

## Growth, trade, and investment

❑ Impact on trade competitiveness : Higher CPI leads to increased imports and decreased exports due to eroded competitiveness (*Prof. Dr. MICHEL HENRY BOUCHET*)

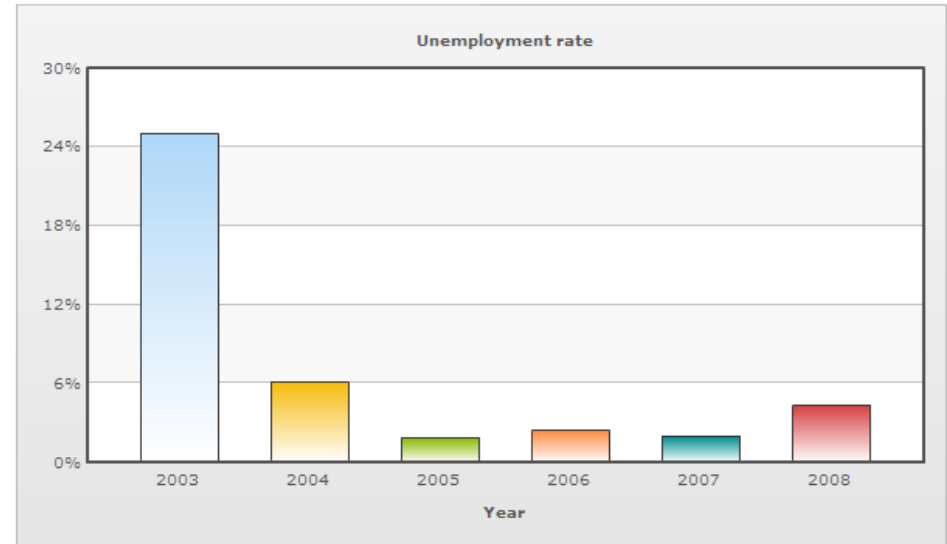
❑ High and uncertain rates of inflation can also discourage private investment and hurt a country's export competitiveness by leading to increases in production costs.



# 3. Inflation in Vietnam's economy: Pressures

## Labor and social issues

- ❑ Inflation is essentially a regressive tax that hits the poor the hardest
- ❑ Factory workers and the elderly, the people most affected by the steep rise in prices, would welcome some relief as their purchasing power for essential items has been severely reduced.
- ❑ The government's regular increases in minimum wages have been wiped out by soaring consumer prices
- ❑ It redistributes income from people on fixed incomes (that do not rise with inflation) to people on variable incomes (that do rise with inflation) → redistribute income from the poor to the rich.
- ❑ Increasing unemployment.



Year	Unemployment rate	Rank	Percent Change	Date of Information
2003	25.00 %	34		1995 est.
2004	6.10 %	135	-75.60 %	2003 est.
2005	1.90 %	12	-68.85 %	2004 est.
2006	2.40 %	21	26.32 %	2005 est.
2007	2.00 %	14	-16.67 %	2006 est.
2008	4.30 %	53	115.00 %	2007 est.

(Source: index mundi)

### 3. Inflation in Vietnam's economy: Pressure

#### More difficulties for firms

- Increasing in raw material price and interest rate, tightening in lending
- Minimize operation cost
- High exchange rate
- Business opportunity missing



#### Risks in currency system

Inflation erodes international competitiveness. Exports cost more abroad. This can cause a decrease in demand for exports. That in turn can lead to a decrease in demand for the currency and to a devaluation of the currency. The devaluation may restore exports, but at the cost of making imports more expensive, thus increasing inflation again! It is because inflation erodes international competitiveness that most governments make controlling inflation the central pillar of their economic policy

### 3. Inflation in Vietnam's economy: Positive aspects

- ❑ it is conceivable that Vietnam's somewhat higher rate of inflation may be a benign manifestation of the structural changes underway in a rapidly developing economy
  - ❑ Vietnam's inflation may be a side-effect of an adjustment of relative prices of the sort that would be appropriate when large productivity gains in tradable sectors trigger wage increases, which spill over into the rest of the economy. (*Balassa-Samuelson effect*). If this is the case, inflation can be viewed as a temporary effect of a move towards a new market equilibrium and, as such, it should be no cause for concern.
  - ❑ Good chances for Vietnamese Gov. to improve business environment: Enterprise Law and Investment Law in 2005
  - ❑ Good chances for Vietnamese firms to re-organize their structure.
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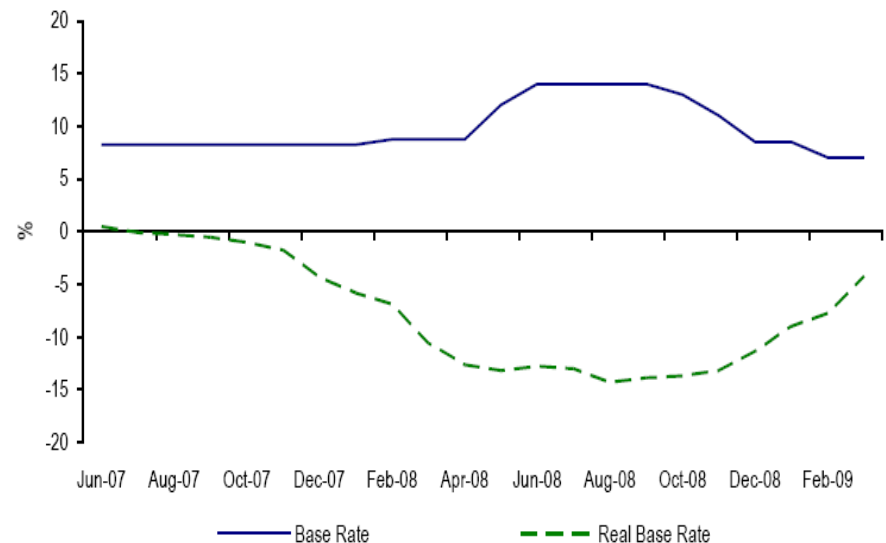
# 3. Inflation in Vietnam's economy: Solution

## Monetary Policy: Increase interest rate to reduce demand

- ❑ Discouraging borrowing by both households and companies.
- ❑ Increasing the rate of saving.
- ❑ Reduce the disposable income of those with mortgages

❑ Government economists cite an infusion of US dollars through overseas remittances and foreign investments as a big contributor to inflation, forcing the central bank to buy back dollars to contain the value of the dong

Chart 5: Policy base rate is falling, but real policy rate is on the rise



# 3. Inflation in Vietnam's economy: Solution

## Fiscal Policy

- ❑ Higher direct taxes (causing a fall in disposable income)
- ❑ Lower Government spending
- ❑ A reduction in the amount the government sector borrows each year



## Exchange rate appreciation

- ❑ A currency appreciation would cut the cost of imported goods and services, as well as import commodities (gasoline, machinery, production materials), hence helping to reduce the CPI.
- ❑ Lowering imported costs will make them cheaper and more competitive, forcing local producers to lower prices to maintain their market share
- ❑ Improbable trio: a central bank cannot stabilize the exchange rate and liberalize the capital account while implementing an independent monetary policy to control inflation. Floating rate frees the central bank from the need to buy foreign exchange and to increase the money supply.
- ❑ Appreciating exchange rate leads people to wish to hold the currency and to own assets priced in this currency, hence reducing the demand pressure and the CPI.

*(Prof. Dr. MICHEL HENRY BOUCHET)*

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### 3. Inflation in Vietnam's economy: Solution

#### Direct wage controls - incomes policies.

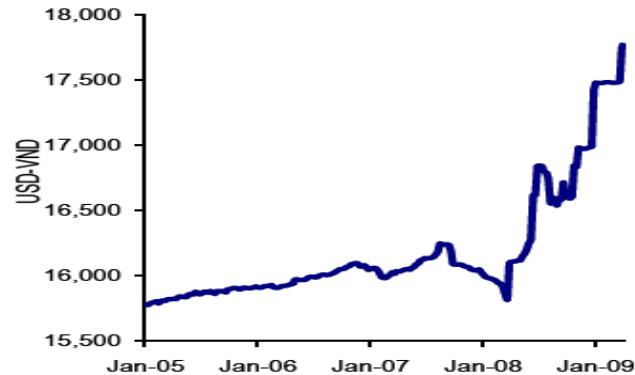
- ❑ Restricting pay rises in the public sector and by setting cash limits for the pay of public sector employees.
- ❑ With private sector, government may try to moral suasion to persuade firms and employees to exercise moderation in wage negotiations

#### Long-term policies

- ❑ **Labour market reforms:** The weakening of trade union power, the growth of part-time and temporary working along with the expansion of flexible working hours are all moves that have increased flexibility in the labour market. If this does allow firms to control their labour costs it may reduce cost push inflationary pressure.
  - ❑ **Supply-side reforms:** Supply side reforms seek to increase the productive capacity of the economy in the long run and raise the trend rate of growth of labour and capital productivity. Productivity gains help to control unit labour costs (an important cause of cost-push inflation) and put less pressure on producers to raise their prices → reduce inflation
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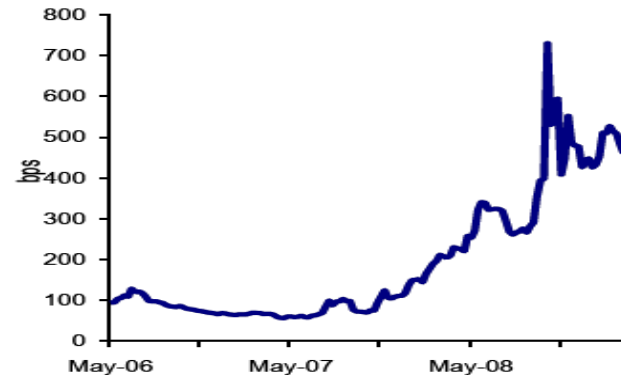
# Vietnam's economy in 2009-Q1: Positive signals

Chart 1: USD-VND exchange rate



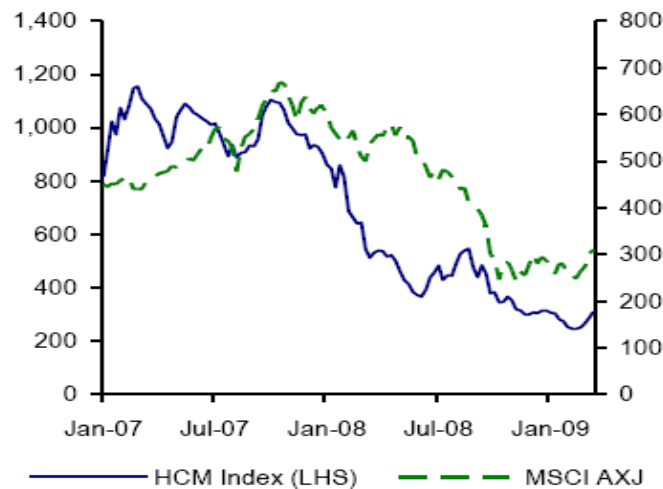
Source: Bloomberg

Chart 2: Vietnam 5Y CDS spread



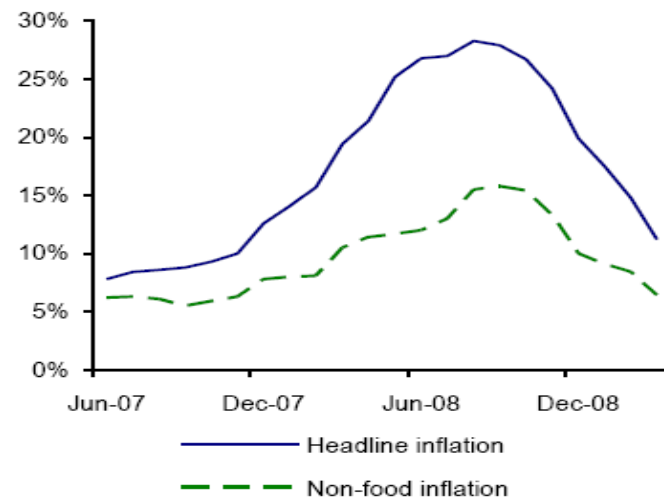
Source: Bloomberg

Chart 3: Ho Chi Minh Index vs. MSCI Asia ex-Japan



Source: Bloomberg

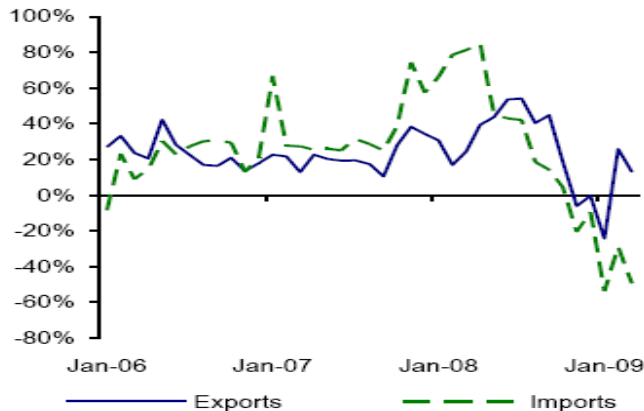
Chart 4: Inflation on a downtrend



Sources: CEIC, SCB Global Research

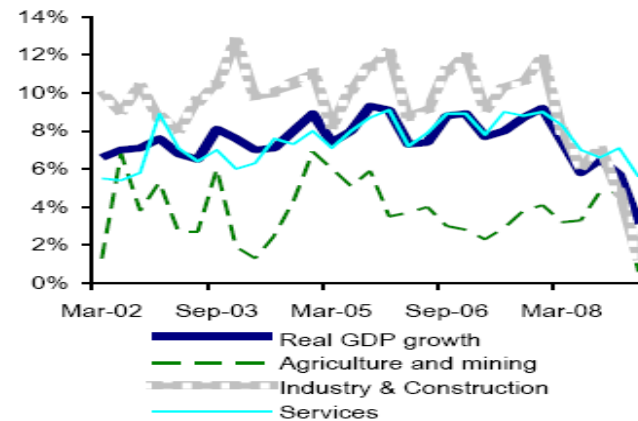
# Outlook for Vietnam's economy in 2009-Q1

**Chart 6: Export growth has rebounded temporarily, while imports continue to collapse**



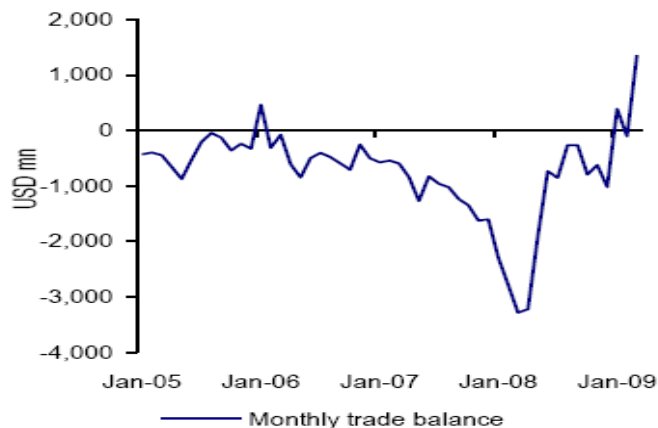
Sources: CEIC, SCB Global Research

**Chart 7: Q1 GDP growth slowdown led by agriculture and industry**

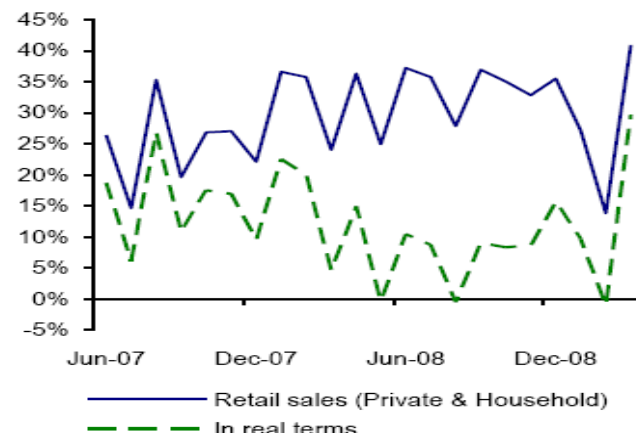


Sources: CEIC, SCB Global Research

**Chart 8: Monthly trade balance now in surplus**



**Chart 9: Retail sales surprisingly resilient**



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**THANK YOU!**

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