VIETNAM BOP & INFLATION

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The BOP and inflation are symbols of severe problems in Vietnam

Current account deficit widens: ~10% of GDP, reached an unprecedented level in 2007.

The trade deficit, 2008 estimated: 20 billion U.S. dollars, or ~30% of GDP

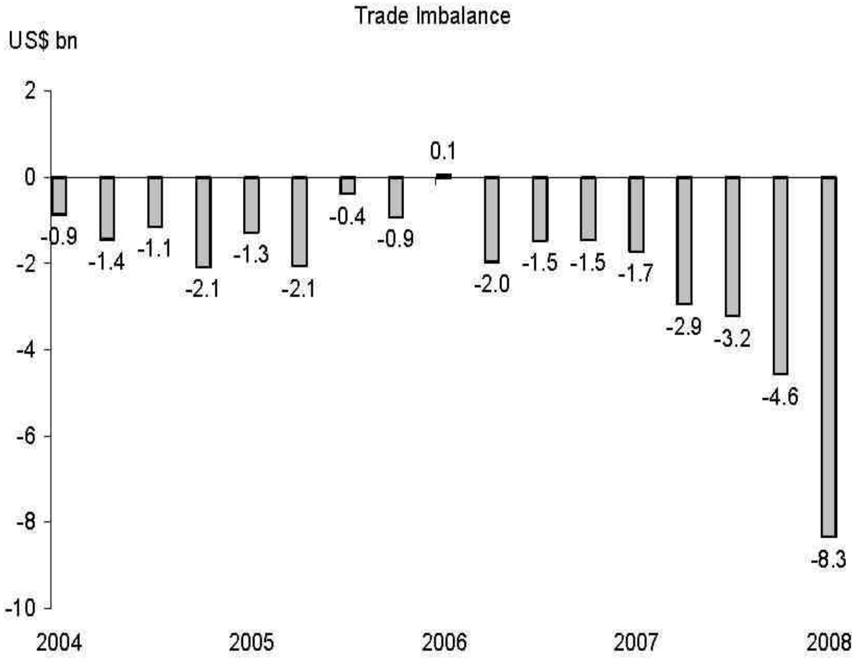
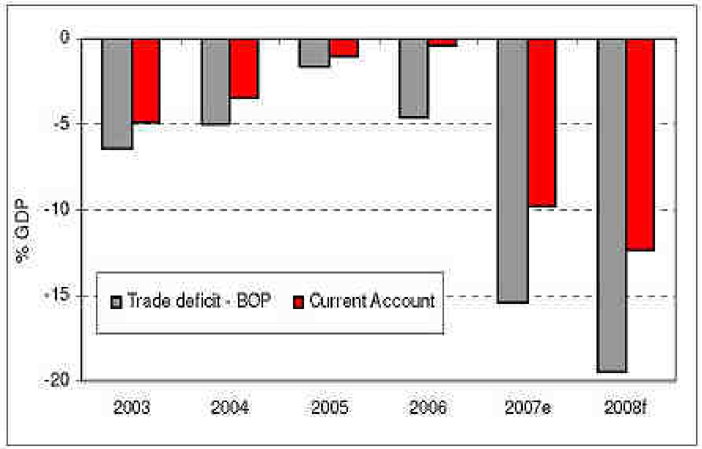


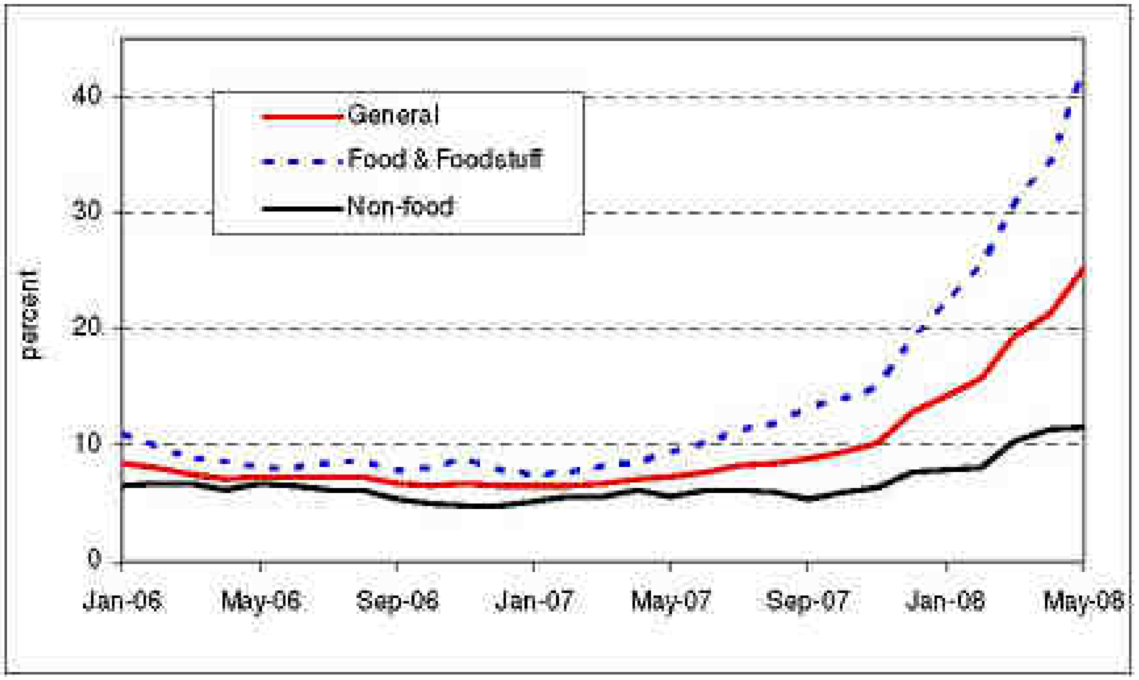
Figure 8: Trade and Current Account Balances



Source: SBV and World Bank.

The BOP and inflation are symbols of severe problems in Vietnam

Inflationary pressures have clearly permeated into the non-food area



Source: Based on data from General Statistics Office (GSO).

CAUSE #1

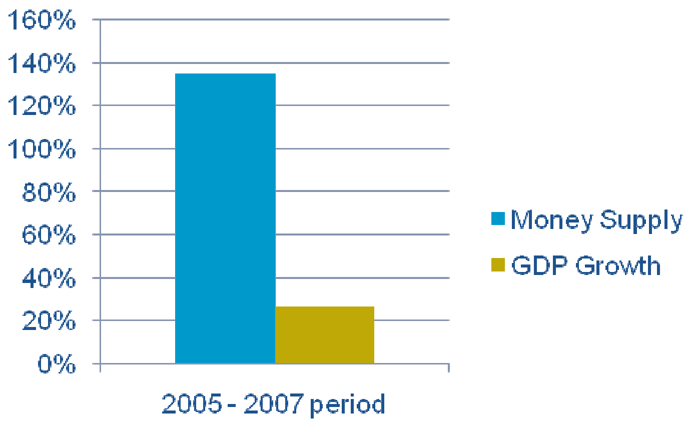
Rapid money supply growth (credit boom) since 2005

Credit growth was caused by the attempt by the State Bank of Vietnam (SBV) to prevent appreciation of the dong in the presence of massive capital inflows, resulted in an equally massive increase in dong liquidity

This rapid expansion of banks reflects their attempt to rapidly gain market share.

Unsterilized liquidity inflow

Banking sector expansion



Money supply in 3 years (2005-2007) increased 135%, while GDP only increased 27%

CAUSE #2 & #3

Overheated economy

Rapid economic growth has been seen as the top priority for Vietnam for many years (largely outstripped its growth potential), and this required both a competitive exchange rate and massive public investment in infrastructure.

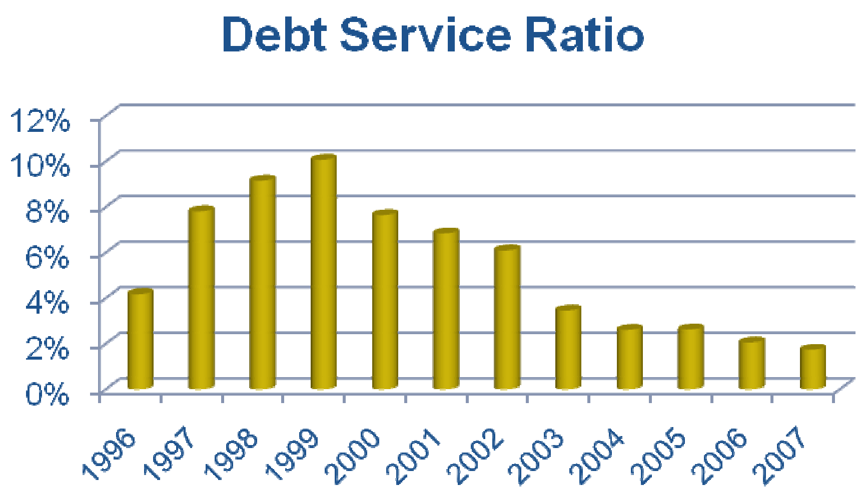
The diversification of large SOEs out of their core businesses: into financial sector and real estate, especially during the asset price bubble of 2007.

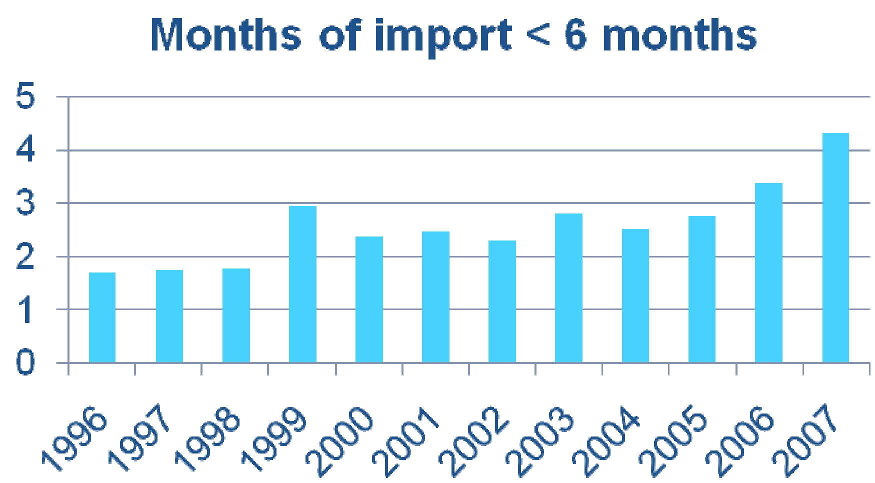
The policy response and its implementation

Capital inflows were at their height and letting the dong depreciate (for export competitiveness) was not a good option.

Trying to preserve the competitiveness of exports, SBV bought more than $10 billion in late 2007. But in doing so, they injected the equivalent in dong into the economy → increase inflation.

ANALYSIS – Liquidity Risk



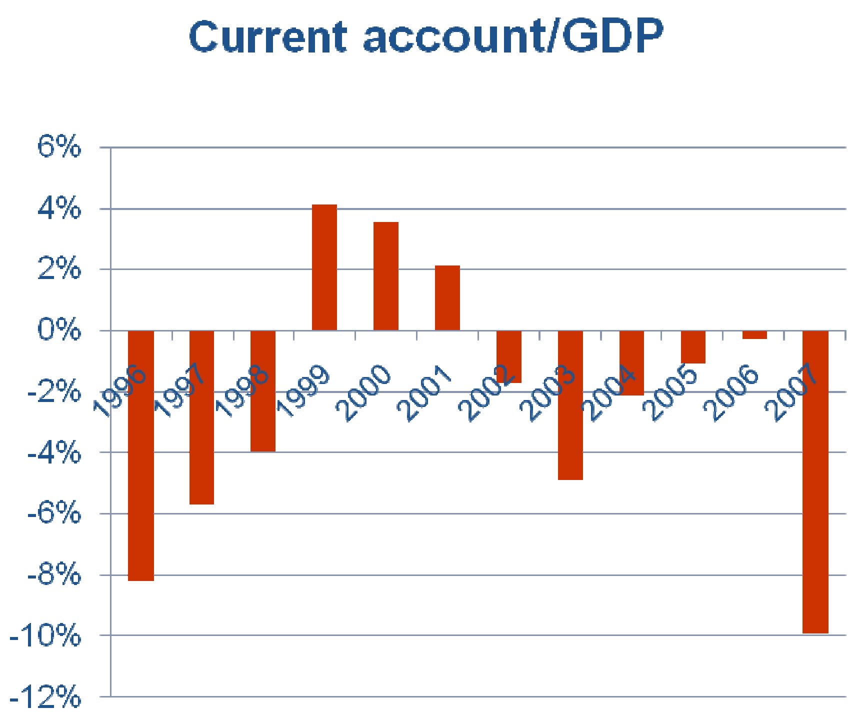


- **Debt Service ratio** at low level < 25% of XGS → ***good ratio***.
- Debt Service ratio has decreased since 2001, due to the economy growth and the increase of export, especially in 2007, which give Vietnam a good shape position.

- **Reserves:** <6 months of import, because of a huge amount of import.
- *However*, it starts looking good from recent years, due to reserves have been increased dramatically, especially in 2007 (which was around $21b – nearly double of 2006.)

ANALYSIS – Liquidity Risk

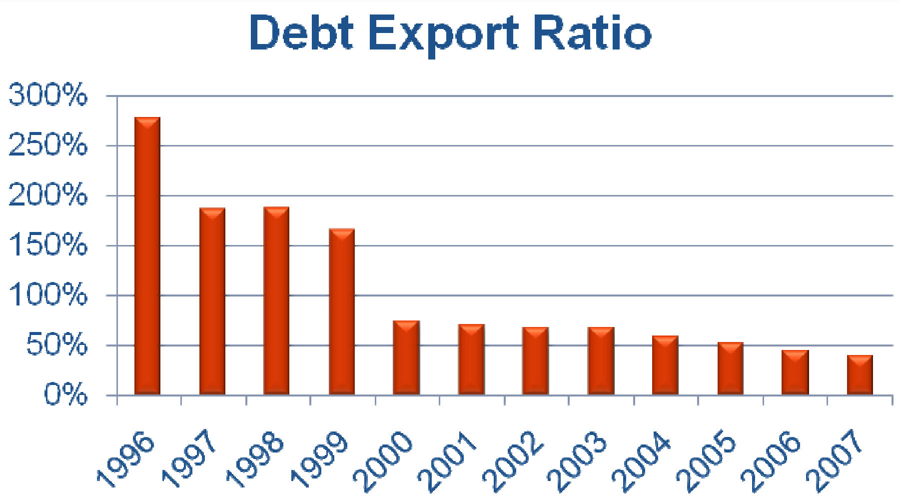
- Although Vietnam has achieved a high GDP growth, this ratio still negative from 2002 with a ***huge deficit in 2007***.

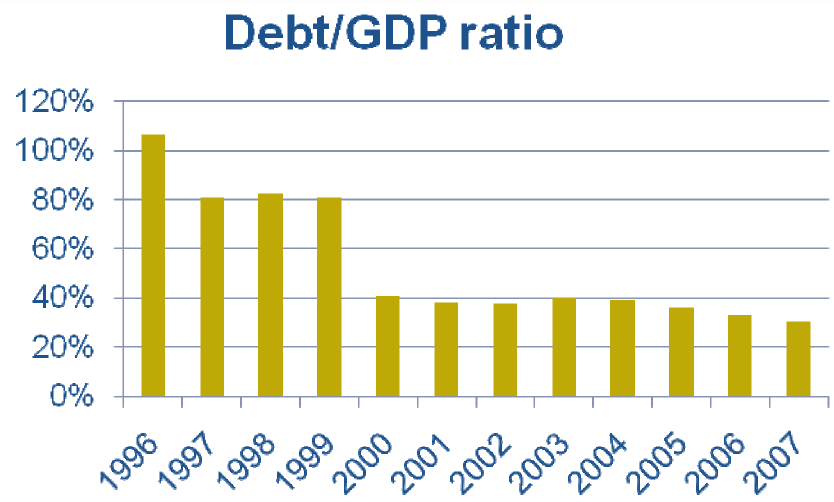


<u>Two main reasons:</u>

- *First,* the swap of share of traditional sectors, agriculture for example, to the industrial and manufacturing sectors (FDI), which need a lot of import of Capital goods.
- *Secondly,* because of the economy growth, Vietnam has enjoyed an important private consumption period, which means high domestic demand, leading to an increase of import; especially luxury goods.

ANALYSIS – Solvency Risk

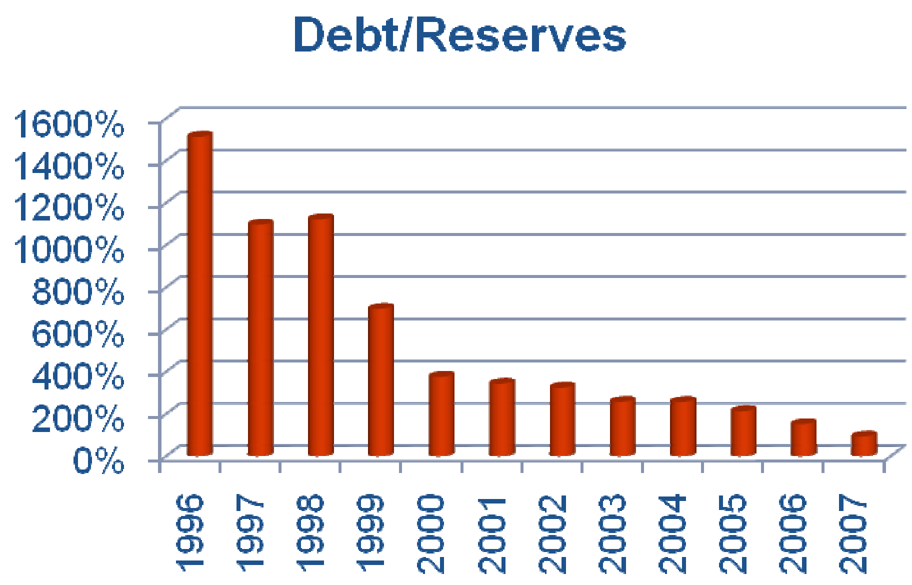




- **Debt export ratio:** Decreases because the total debt (including foreign debt) increases very slow comparing to the export of Vietnam. The main reason behind is the economy growth of Vietnam.

- **Debt/GDP ratio:** The same reason as the debt export ratio.

ANALYSIS – Solvency Risk



- **Debt/reserves ratio** > 150%, even though it decreases quite quickly (thanks to the economy growth), it still needs to be improved, as it is not very good compare to other developing countries.

SOLUTIONS IMPLEMENTED

- **8 GROUPS OF SOLUTIONS, INCLUDING:**

  #1 - Further tightening of monetary policy (e.g. raising reserve ratio)

  #2 - Cutting government expenses and public investment projects

  #3 - Prioritizing agricultural production

  #4 - Promoting exports to reduce the trade deficit

  #5 - Encouraging thrift consumption and production

  #6 - Supervising market movements to avoid speculation and smuggling

  #7 - Implementing social welfare and salaries to help the poor

  #8 - Promote means of communication to propagandize transparent and precise information

SOLUTIONS IMPLEMENTED

ARE THESE 8 SOLUTIONS RIGHT & ENOUGH?

- **Some of above measures likely are helpful in containing inflationary pressures, while others not…**

- In a highly inflationary environment, Vietnam will likely benefit from moderate fiscal consolidation

- Administrative controls over price and exports could create more distortions in the system

THE BOTTOM LINE, WE BELIEVE, IS MONETARY POLICY

OUR RECOMMENDATIONS

- Increase skilled-labour and R&D expenditure.
- Stricter regulation in FDI flow.
- Promote proper loan to deposit ratio.
- Impose higher tax on non productive goods, especially luxury goods.
- More decisive action is needed in relation to public investment projects and government spending.

OUR RECOMMENDATIONS

- The government should therefore continue the implementation of its credit policy; however, priority should be given to financial sector stability.
- Encouraging households to join in more productivity sector.
- Improving confidence in Stock market in order to attract portfolio investment.
- The government should have some strategies to protect the weakest banks (or small banks) if all the burden of adjustment falls on credit policy.

ANOTHER PERSPECTIVE: CASE OF TURKEY

- MAJOR CHARACTERISTIC OF TURKISH ECONOMY UNTIL THE 2001 CRISIS :

"HIGH AND PERSISTENT INFLATION"

AVERAGE INFLATION RATE DURING 1990-1999 76.1%

DECREASING SHARPLY IN 2003 FROM 45.1% TO 25.3%

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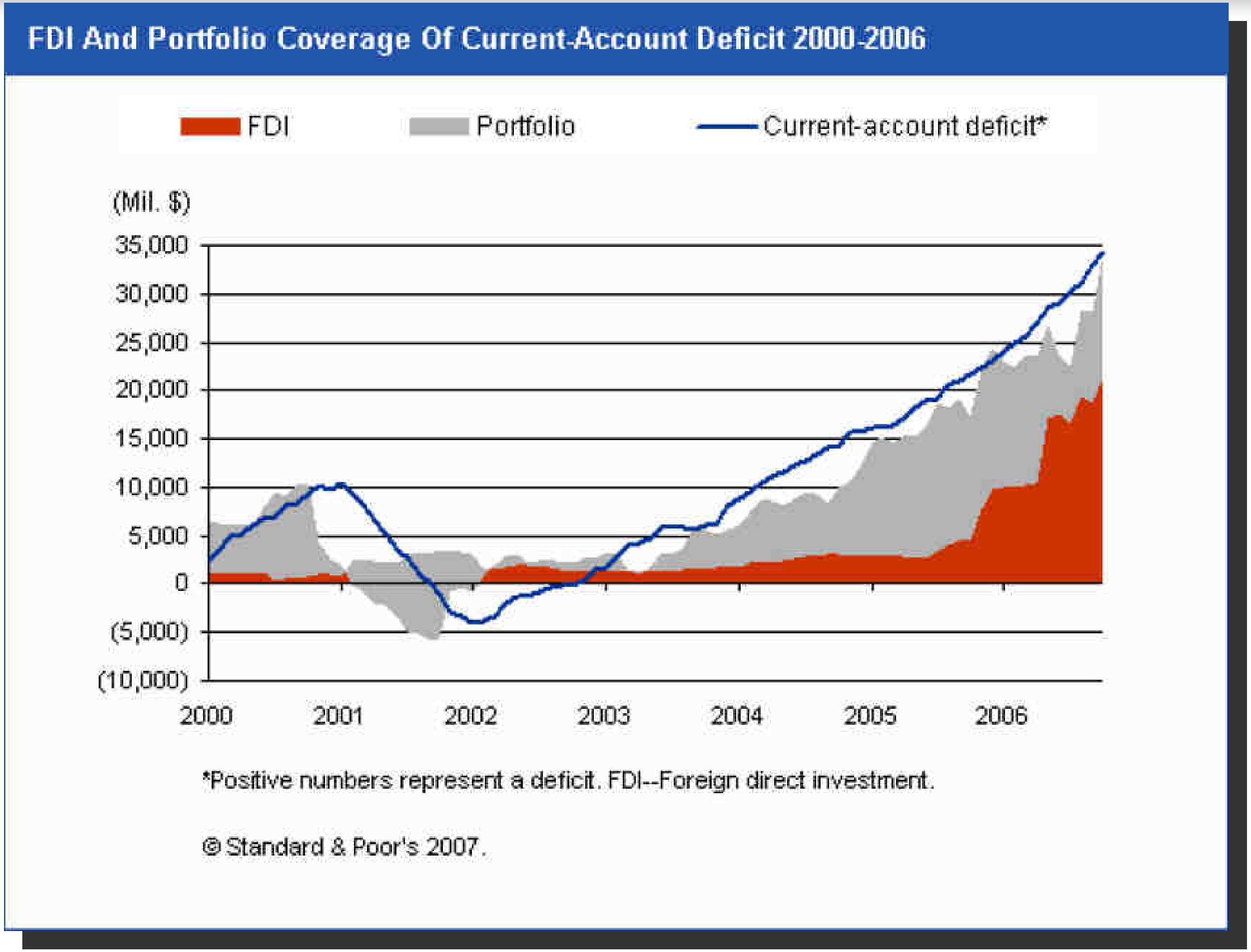
Current Account Deficit



TURKEY

- **CAUSES :**

LARGE FISCAL DEFICIT

LOOSE INCOME POLICY

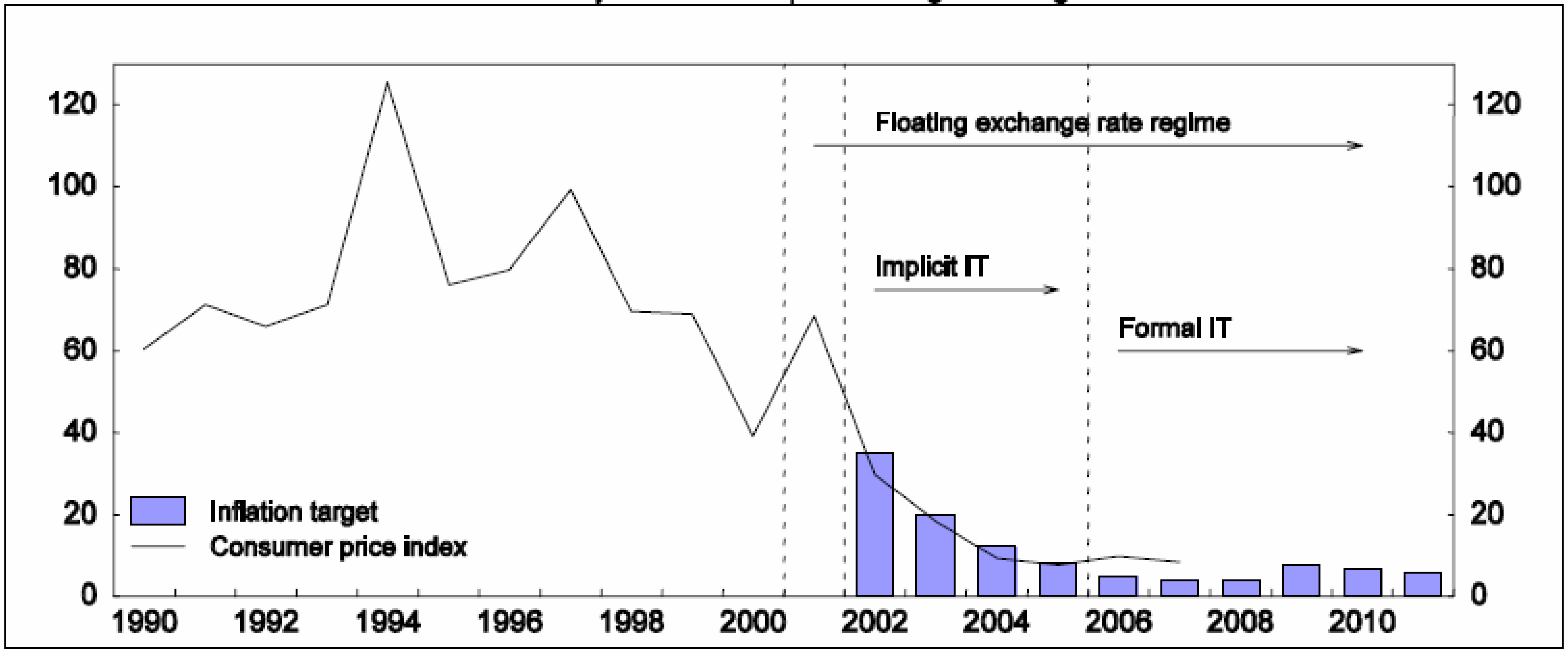
PRICING POLICY OF PUBLIC UTILITIES

UNSTABLE MACRO-ECONOMIC & POLITICAL ENVIRONMENT

TURKEY

Inflation Rates in Turkey

End-of-year annual percentage change



Source: Turkstat, CBRT.

TURKEY

POST-2001 CRISIS

“Transition to a Stronger Turkish Economy Programme”

- Central bank independence
- Introduction to floating exchange rate regime
- Structural reforms
- Short-term interest rate as main policy instrument

VIETNAM & TURKEY

- Facing same problems in their economies: ***High current account deficit and inflation***

- *But ...*
  1. Different root causes
  2. Different policy

VIETNAM & TURKEY

	Vietnam	Turkey
Root cause	Overheating Economy	Public Sector Imbalances
Policy	Tight monetary policy and fiscal consolidation	Inflation Targeting
Key of success	The policy implementation decreased inflation rate from 28.3% in Aug 2008, to 26.7% and 24.2% in Oct and Nov 2008	(From 2001-2005) Central bank independence Productivity gain & wage moderation Fiscal consolidation and financial sector rehabilitation

SOURCES

- IMF
- BIS

KEY ECONOMIC RATIOS and LONG-TERM TRENDS

World Bank 2007 - Estimated	1987	1997	2006	2007
GDP *(US$ billions)*	36.7	26.8	61.0	71.2
Gross capital formation/GDP	13.6	28.3	35.7	35.3
Exports of goods and services/GDP	6.0	43.1	73.5	75.7
Gross domestic savings/GDP	4.8	20.2	32.4	27.4
Gross national savings/GDP	..	21.6	36.9	32.8
Current account balance/GDP	-1.6	-6.2	-0.3	-3.1
Interest payments/GDP	0.0	1.0	0.5	..
Total debt/GDP	0.5	81.1	33.1	..
Total debt service/exports	..	7.7	2.0	..
Present value of debt/GDP	..	..	27.9	..
Present value of debt/exports	..	..	37.3	..