RESTRUCTURING FOR A MORE COMPETITIVE VIETNAM

MACROECONOMIC REPORT
SECOND QUARTER 2016

INTRODUCTION

Q2 witnessed the change in top Government personnel. The National Assembly (term XIII) has elected Prime Minister and approved Deputy Prime Ministers and members of the Cabinet. The Government presented key messages on fostering a more predictable policy framework, encouraging and nurturing entrepreneurship, and promoting economic growth. The freedom of doing business was re-affirmed through the decisive and prompt measures to address specific issues. These changes clearly "matched" expectation of the business community and individuals, particularly after significant improvements of business environment since 2014 (with amendment of Enterprise Law, Investment Law, and Resolutions 19 of 2014 and 2015, etc.). In turn, expectation of higher and more sustainable economic growth in the second half of 2016 and beyond has been rising.

The Macroeconomic Report for Q2/2016 serves several objectives, including: (i) to update macroeconomic development and policy changes in Q2 and the first sixth months of 2016, with evidence-based analysis and perspectives of experts/Central Institute for Economic Management (CIEM); (ii) to assess the macroeconomic outlook for Q3 and 2016; (iii) to cover selected economic issues based on quantitative and/or qualitative assessment; and (iv) to propose recommendation on economic reforms (including institutional reforms) and on policy solutions for macroeconomic management in the last sixth months of 2016 and beyond.

This Report benefits from many valuable feedbacks of various experts from CIEM and other Ministries and agencies.

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All remaining errors, views and opinions presented in the Report are solely of the authors and may not necessary reflecting those of RCV Project and/or CIEM.

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ABBREVIATION

AEC	ASEAN Economic Community
AFF	Agriculture-Fishery-Forestry
ASEAN	Association of Southeast Asian Nations
CIEM	Central Institute for Economic Management
CNY	Chinese Yuan
CPI	Consumer Price Index
DVA	Domestic value added
EIA	Environmental Impact Assessment
EP	Environmental Protection
EU	European Union
FDI	Foreign Direct Investment
FED	Federal Reserve System
FTA	Free Trade Agreement
GBY	British Sterling Pound
GDP	Gross Domestic Product
GSO	General Statistic Office
IFS	International Financial Statistics
IIF	The Institute of International Finance
IIP	Index of Industrial Production
IMF	International Monetary Fund
IP	Industrial park
JPY	Japanese Yen
M2	Total liquidity
MOF	Ministry of Finance
MOF	Ministry of Health
MOIT	Ministry of Industry and Trade
MOT	Ministry of Transport
MPI	Ministry of Planning and Investment
MUTRAP	European Trade Policy and Investment Support Project
NCIF	National Centre for Socio-Economic Information and Forecast
NPL	Non-performing loan
OECD	Organization for Economic Co-operation and Development
PMI	Purchasing Managers Index
QoQ	Quarter-on-quarter
RCEP	Regional Comprehensive Economic Partnership

REER	Real Effective Exchange Rate
SBV	State Bank of Vietnam
SCIC	State Capital Investment Corporation
SOE	State-owned Enterprise
TPP	Trans-Pacific Partnership
TTIP	Trans-Atlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
USD	US Dollar
VA	Value-added
VND	Vietnam Dong
WB	World Bank
YoY	Year-on-year

EXECUTIVE SUMMARRY

1. The global economic context still resembles substances of difficulty and uncertainty. Growth recovery was slow, without signs of overcoming economic downturn, in both advanced and emerging economies. International organizations (IMF, WB) lowered forecasts of economic growth in 2016-2017 in major and emerging economies. The US economy showed signs of recovery, yet remains to be watched. Political complexities in the EU, including the referendum on United Kingdom membership of the EU, significantly weakened investors' confidence and regional growth prospects. Japan was projected to increase only by 0.5% in Q2, and growth rate of China decelerate further in Q2.
2. Trade and investment showed little improvement. Brexit just led to overshooting in the short-term, including the depreciation of GBP and Euro, and the relative appreciation of USD and JPY. International gold price soared. International commodity prices hardly depicted a clear trend.
3. The negotiation, signing and implementation of FTAs continued to progress. TPP members were seeking ratification of the agreement in the 2nd half of 2016. EU-Japan FTA attained more results in negotiation and was expected to conclude in 2016. RCEP needs more efforts from its members should they want to conclude negotiation by the end of 2016.
4. Q2 witnessed the initial efforts of top Government personnel in socio-economic management. As the first highlight, the new Government renewed efforts in creating favorable business environment, with fewer unnecessary barriers for improving competitive efficiency in the market. The Government also enlivened business environment reforms with the series of Resolutions 19. In addition to institutional improvement, the Government directly acted to facilitate business and production of enterprises.
5. Limitations and difficulties persisted in the recent socio-economic management and business environment reforms. Some Ministries and agencies were still slow in concretizing actions. A long-term vision, with specific priorities for sustainable development, remained absent. Balancing the policy objectives was not easy, and is actually becoming more challenging.
6. Economic growth was yet to regain recovery. GDP grew by 5.57% in Q2/2016. In the first 6 months, GDP growth reached 5.52%. The growth target for 2016 becomes almost unattainable. Actual GDP was negligibly improved relative to potential level. Gross capital formation and final consumption significantly induced overall GDP growth in Q2.
7. Slow recovery of the global economy, in the context of further and deeper economic integration, adversely affected the economic prospects of Vietnam. Nevertheless, Vietnam's GDP growth remained higher than some countries.
8. Growth of industry and construction attained 7.61% in Q2. The Index of Industrial Production (IIP) rose by 7.5% in the first 6 months. Higher consumption and investment demand helped prevent the industrial downturn in

the first half of 2016. PMI was high and stable throughout Q2, due to: (i) gradually improved domestic business conditions; (ii) business and investors' confidence on the prospects of economic recovery; (iii) increasing orders (both domestically and export); and (iv) slightly fall of production costs.

9. AFF experienced some positive, though not sizeable, growth in Q2. Value-added of AFF went up by 0.06% in Q2, but dropped by 0.18% for the first 6 months of 2016. Value-added of services sector grew by 6.6% in Q2. For the first 6 months of 2016, services sector growth attained 6.35% - the highest since 2012. Economic structure depicted slight change in Q2/2016.

10. The growth of enterprises in Q2 and the first 6 months of 2016 was 16.6% and 20% respectively. This movement was due to: (i) positive impacts of Enterprise Law, Investment Law and initial impacts of policy measures by the Government; and (ii) improved confidence of the business community and investors on economic prospects of Vietnam as well as opportunities from new generation FTAs. The manufacturing enterprises had a positive assessment of production and business trend in Q2. However, enterprises still encountered difficulties. The number of dissolved enterprises increased by 20.7% (YoY).

11. As of 1 July 2016, total labor force of the country was 54.36 million people, increasing by 1.22%. Labor structure by economic sector had almost no change. The working-age unemployment rate was 2.3% in Q2. For the first 6 months, the working-age unemployment rate was 2.27%, of which the urban figure was 3.18%; and that of rural area was 1.81%.

12. CPI increased relatively rapidly in Q2. CPI was up by 1.35% in Q2. Overall, CPI rose by 1.72% in the first 6 months of 2016 (YoY). Inflation in the first 6 months was mainly induced by cost-push factors. There remains several risks and pressures on price management in the second half of 2016, including: (i) upward adjustment of state-controlled price of some goods and services; (ii) almost no reduction of domestic interest rates; and (iii) volatility of foreign capital flows.

13. The VND-denominated deposit rate (for terms shorter than 6 months) was stable and below the ceiling imposed by the SBV. Competition among commercial banks to mobilize deposits was relieved in Q2. USD-denominated deposit rates for individuals and economic entities remained unchanged at 0% per annum. VND- and USD-denominated lending rates decreased insignificantly in Q2.

14. Outstanding credit was estimated to grow by about 4.96% compared to Q1 and 8.16% compared to the end of 2015. YoY growth rate of outstanding credit only varied slightly between Q1 and Q2, mainly attributed to (i) more rapid credit disbursement in Q1; (ii) increasing Government bond issuance and crowding out effects on credit; and (iii) lack of robust growth recovery which increased enterprises' caution in borrowing decisions. NPLs were short of improvement, rising slightly to 2.62% by the end of March. Total liquidity (M2) was estimated to grow by 4.84% in Q2 and 8.07% in the first 6 months.

15. The management of VND/USD exchange rate was a remarkable success in the first 6 months. The central VND/USD rate was flexibly adjusted and quite

stable, except the rapid increase at the end of May. The foreign exchange market was under insignificant pressure in Q2. REER of Vietnam went down by 0.34% in Q2, implying that Vietnamese goods became more expensive relative to foreign ones.

16. Gross investment was estimated to reach VND 341.7 trillion in Q2, rising by 12.9%. For the first 6 months, gross investment attained VND 618.2 trillion, increasing by 11.7%. The investment to GDP ratio was 33.5%. Investment expansion was smaller than expectation in the first 6 months of 2016, equivalent to only 40% of the plan for 2016. FDI attraction was an important achievement. In Q2, there were 672 newly-licensed FDI projects with total registered capital of about USD 4.7 billion. Implemented FDI capital was USD 3.8 billion in Q2, increasing by 16.9%.

17. Exports attained USD 43.4 billion in Q2 (increasing by 4.9%) and USD 82.1 billion in the first 6 months (increasing by 5.7%). Export growth remained lower than the target for 2016. Export growth was mainly attributed to FDI sector. Imports were estimated at USD 43.0 billion in Q2, increasing by 2.2%; of which, import value of the FDI sector was USD 24.6 billion. For the first 6 months of 2016, imports amounted to USD 80.4 billion, decreasing by 0.8%.

18. Total retail sales of goods and services amounted to VND 1,724 trillion in the first 6 months, rising by 9.5%. Retail sales of goods still accounted for the largest share (76.2%), attaining VND 1,314.3 trillion, up by 9.8%.

19. Budget revenues attained VND 246.3 trillion in Q2/2016, up by 6.8% (QoQ) and by 11.9% (YoY). For the first 6 months, budget revenues were estimated at VND 476.8 trillion, equal to 47.0% of the planned figures for 2016. Budget revenues to GDP ratio dropped from 27.1% in Q1 to 23.9% in Q2. Budget expenditures amounted to VND 269.4 trillion, increasing by 2.4% (QoQ) and by 0.6% (YoY) in Q2. For the first 6 months of 2016, budget expenditures were equal to 41.8% of the planned figures for 2016. Government bond issuance amounted to VND 109.1 trillion in Q2, up by 49.1% (QoQ).

20. YoY GDP growth rate in Q3 is projected at 6.14%. Export growth in Q3 (YoY) may reach 6.8%. Trade deficit is projected at USD 0.4 billion. CPI may increase by 1.31% in Q3.

21. The Report analyzed challenges from joining AEC. *Firstly*, ASEAN members are quite different in terms of development level and they compete against one another in exports and attraction of FDI; thus, the intra-regional integration commitments of ASEAN are somewhat short of incentives and less meaningful. *Second*, managerial agencies and enterprises lack full understanding of or attention to competitive pressures in light of AEC integration. *Third*, strengthening competitiveness of Vietnam's businesses is no easy task. The fourth challenge is how to enhance the participation of Vietnam enterprises in the regional supply chain. *Fifth*, it is not easy to take advantages of abundant labors and natural resources while moving up the value chain for higher value-added industries in ASEAN. *Finally*, Vietnam may face challenges in harmonizing the commitments and integration tracks for maximizing benefits

and opportunities. The Report then makes some policy implications to address AEC challenges in the years ahead.

22. The Report provides deeper analysis on the risks and challenges in establishing specialized agency acting as state-ownership representative. Such risks and challenges come mainly from resistance to proposed changes in the power and interests in management and supervision of SOEs and the state capital invested in enterprises. It is thus crucial to have a meaningful efforts and political support of leaders of the State and the Government and the support of the business community of all economic sectors, as well as of other stakeholders, particularly representatives of the people, the press and mass media organizations.

23. Minimizing environmental impacts of FDI were also covered at length. Provisions on environmental protection are specified in many legal documents, which shape a legal framework to reduce adverse environmental impacts caused by enterprises in general and FDI firms in particular on Vietnam's economy. In general, FDI enterprises' compliance with environmental regulations is relatively good; however, some IPs and firms located inside the IPs have not strictly followed environmental regulations. The coordination and supervision of environmental protection in IP carried out by managerial agencies was not strictly implemented. Further improvement of environmental policies is still needed, particularly in terms of enforcement and efficiency.

24. The new governmental apparatus has promptly engaged in socio-economic management, together with accelerating reforms of microeconomic foundation. Meaningful policy changes were noticeable. Being less impressive than expected, the socio-economic outcomes in Q2 could hardly overshadow the tremendous attempts of the Government. In fact, ample difficulties and volatilities continued to have material impacts on the global and regional economy in Q2. Inherent shortcomings of Vietnam's growth paradigm also take time to resolve. Still, Vietnam's economic growth and export expansion outpaced other countries in the region. Hence, targeting high economic growth at all costs is hardly justified. Instead, the Government should be determined in prioritizing microeconomic reforms, sustaining and building policy space for macroeconomic management. In this context, the policy recommendations to improve microeconomic foundation and macroeconomic policy management – as per preceding Macroeconomic Reports of the CIEM – remain valid. In addition to proposing further reforms of microeconomic foundations in the forthcoming quarters, the Report also makes various recommendations related to monetary, fiscal, trade, price and salary policies./.

I. ECONOMIC CONTEXT IN Q2 AND FIRST 6 MONTHS OF 2016

1. *Global and regional economic context*

1. The global economic context still resembles substances of difficulty and uncertainty. Growth recovery was slow, without signs of overcoming economic downturn, in both advanced and emerging economies. The international organizations such as International Monetary Fund (IMF) and World Bank lowered their forecast of economic growth in 2016-2017 in major and emerging economies (Table 1). Low interest rates and loosened monetary policies were popular in various economies to support growth and stimulate consumption[1]. However, lack of consensus over issues of security, sovereignty, terrorism, immigration, etc. adversely affected the formulation and implementation of pro-growth policy in some regions. To this extent, efforts to leverage inter-regional and inter-economy cooperation – to induce more robust global economic growth – failed to go past formal declarations.

2. The US economy showed signs of recovery. According to the 3rd adjusted figures, GDP grew by 1.1% in Q1 (YoY, higher than previous estimates of 0.5% and 0.8%). Increases in private consumption, local government expenditures and exports were key drivers for economic growth. Unemployment rate decreased by 0.3 percentage point to 4.7% in May[2]. FED still left open the possibility of interest rate hike, despite no actual adjustment in Q2.[3]

3. Political complexities in the EU, including the referendum on the United Kingdom exiting the EU (Brexit), significantly weakened investors' confidence and regional growth prospects. PMI fell to the lowest level since Q1/2014[4]. The consequences were further magnified as the EU was facing inherent problems such as high rate of public debts, low investment rate, high unemployment rate and migration crisis, etc.

4. Japan was projected to grow only by 0.5% in Q2[5] and 0.3% in 2016. Underlying such growth forecasts were the slowdown of private consumption, and volatilities of financial and capital markets[6]. Production was stagnant: the PMI remained below 50 for the last 4 consecutive months, and only attained 47.8 in June - the lowest level since December 2012. JPY appreciated markedly, albeit only temporarily after the Brexit, which adversely affected Japan's exports and inflation. In turn, the international financial market was

[1] On 6 August 2016, the Reserve Bank of Australia decided to retain its lowest rate of 1.75%; the UK Monetary Policy Committee decided to keep the rate of 0.5%, and left unchanged the target inflation of 2%; At the Monetary Policy Meeting, the Bank of Japan continued the negative rate (-0.1%) which had been applied since March 2016.

[2] http://www.bls.gov/news.release/empsit.nr0.htm

[3] http://www.reuters.com/article/us-usa-economy-jobless-idUSKCN0YA1MN

[4] https://www.markiteconomics.com/Survey/PressRelease.mvc/cf09a2e2e0c54c76892f039e829ef464

[5] http://www.reuters.com/article/us-japan-economy-pmi-idUSKCN0Z9059

[6] http://www.mofa.go.jp/policy/economy/japan/

subject to risk of volatility should the Japanese Government intervene to depreciate the JPY.

5. Growth rate of China may decelerate further in Q2. PMI attained only 50.1 in May and might fall to 50 in June. The growth of retail sales continuously contracted in Q2 and hit the trough for the past many years[7]. Public debt[8], non-performing loans[9], excess industrial capacity crisis (steel and iron, materials, etc.) and financial instability in China significantly undermined investors' confidence. The European Parliament is yet to recognize China as full market economy, which restricted the latter's access to EU markets. The Government of China continued to loosen monetary policy to boost liquidity and promote growth[10]. On 24 June, right after the Brexit, the People's Bank of China also lowered the reference CNY/USD exchange rate by 0.9%, to the lowest rate since 2011.[11]

Table 1: Economic outlook in some major economies

Unit: %

	2016	*2017*	*Difference**	
			2016	*2017*
World GDP (growth rate: %)	3.1	3.4	-0.1	-0.1
Developed countries	1.8	1.8	-0.1	-0.2
United States	*2.2*	*2.5*	-0.2	0.0
Japan	*0.3*	*0.1*	-0.2	0.2
Euro zone	*1.6*	*1.4*	0.1	-0.2
Developing and emerging economies	4.1	4.6	0.0	0.0
Developing countries in Asia	6.4	6.3	0.0	0.0
China	*6.6*	*6.2*	0.1	0.0
ASEAN-5	*4.8*	*5.1*	0.0	0.0
World trade (growth rate, %)	2.7	3.9	-0.4	0.1
Non-fuel price (% increase, USD)	-3.8	-0.6	5.6	0.1

Source: IMF (July 2016).

Note: *Difference between the forecasts in April 2016 compared with those in January 2016.

ASEAN-5 includes Indonesia, Malaysia, Philippines, Vietnam and Thailand.

6. The first and direct consequences of Brexit were the overshooting, complications and uncertainties of international financial market. Since the

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[7] The growth of retail sale was up by 10% in May.

[8] The debt/GDP ratio was estimated at 250% GDP in China (Source: https://www.theguardian.com/business/2016/jun/16/chinas-debt-is-250-of-gdp-and-could-be-fatal-says-government-expert)

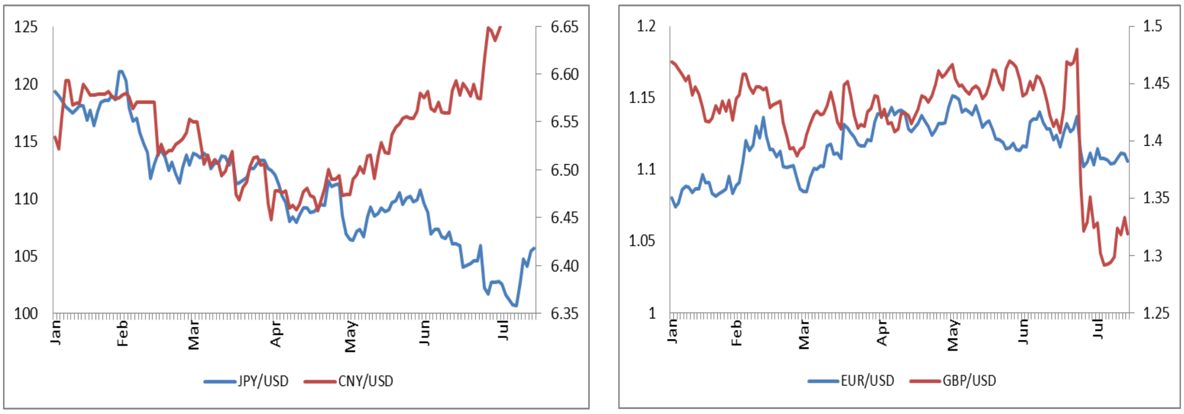
[9] Non-performing loans increased by 41.7% (YoY) by the end of March 2016 in China, reaching to USD 213 billion (Source: http://asia.nikkei.com/Politics-Economy/Economy/Chinese-banks-bad-debt-soars-41)

[10] By 22 April, China pumped about USD 409 billion to circulation in the economy.

[11] The reference rate of NDT/USD was 6.5693 on 25 May (down by 0.3%), and was even lower to 6.6375 on Friday, 24 June.

announcement of preliminary voting results, the stock market crashed almost worldwide[12]. Brexit then led to the devaluation of GBP and Euro, and the relative appreciation of USD and JPY. From 23 to 28 June, the USD index went up by 3.1% in international market; Euro and GBP went down by 2.8% and 10.0%, respectively, against USD, and by 6.3% and 13.2%, respectively, against JPY. International gold price soared (by 4.5% during 23-30 June) when investors sought safe haven (Figure 2).

Figure 1: Exchange rates of selected currencies to USD in 2016



Source: US Federal Reserve (https://www.federalreserve.gov).

7. In the context of slow and uncertain recovery of global economy, global trade was projected to rise more slowly in 2016. Exports contracted noticeably in Q2, even in major export-oriented economies like China and Thailand. Brexit is yet to produce impacts on global trade in general and EU in particular. However, the deceleration of trade growth may be more modest in the 2^{nd} half of 2016.

8. Investment showed little improvement. UNCTAD estimated that global FDI could be reduced by 10-15% in 2016, the transaction value of merge and acquisition was level-off. FDI inflows to Asia was estimated to decline by 15% while those to transition economies increased[13]. Nevertheless, capital withdrawal from emerging economies was forecasted at USD 350 billion in 2016,[14] lower than the forecast in April 2016 (USD 448 billion) and estimate for 2015 (USD 750 billion). Main reason included the lower interest rates in developed economies (especially after the Brexit).

9. International commodity prices hardly depicted a clear trend (Figure 3). International food price index rose only slightly in Q2[15]. The world oil prices

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[12] At the closing session on 24 June, the Dow Jones fell by 610.32 points (or 3.39%); S&P 500 fell by 75.9 points (or 3.59%); Nasdaq fell by 202.06 points (or 4.12%) in the US market. Stoxx600 index showed a fall by 7% in the European stock market, the lowest level since 2008; FTSE250 of UK market went down by 7.2%, at the lowest since 1988. Spanish and Italian stock market declined by 12.35% and 12.5% respectively. In Asia, Nikkei 225 index of Japan fell by 8.12%; Hang Seng index reduced by 4.65%; etc. Interest rates imposed by many governments were at lowest level: Germany (-0.169%); UK (1.008%), US (1.419%), etc. (Source: http://vneconomy.vn)

[13] Source: World Investment Report 2016 (UNCTAD)

[14] According to a forecast of International Institute of Finance (IIF) in July 2016.

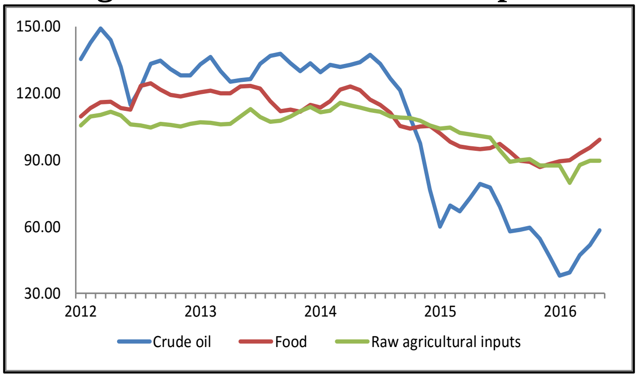
[15] Food price index of FAO (FFPI) increased by 3.2% in May as compared to April, but was still lower than YoY index of 7% (Source: http://www.fao.org/worldfoodsituation/foodpricesindex/en/)

fluctuated, attaining above USD 50/barrel in May and then dropping sharply after Brexit. Forecast showed that oil price can slightly recover in the second half of 2016 due to rising demand and disruption of supply, yet might still be below USD 50/barrel.

Figure 2: International gold price

Source: Goldprice.org

Figure 3: Crude oil and food price



Source: IFS.

10. The negotiation, signing and implementation of Free Trade Agreements (FTAs) continued to progress. TPP members were seeking ratification of the agreement in the 2nd half of 2016. EU-Japan FTA attained more results in negotiation and was expected to conclude in 2016. The Regional Comprehensive Economic Partnership (RCEP) needs more efforts from its members should they want to conclude negotiation by the end of 2016.

11. The consequences of Brexit can be long-lasting and difficult to forecast. Brexit may reflect a “temporary step-back” in international integration and globalization, especially in the lack of consensus of members in dealing with common issues, as well as individual members’ conflicting views of national-international benefits. Even the referendum of UK from EU may take as long as 2 years. The consequences include: (i) prolonged and/or severe instability within EU, with possible indirect effects on regional economy; (ii) slow-down or delay in FTA negotiation of EU (TTIP; TPP; FTA with Japan, Korea, and 7 ASEAN members, etc.). Such consequences can be more complicated if there are major follow-up policy changes in major economies, such as the intervention of Japan into JPY rate, the internationalization of CNY, etc.

2. Domestic economic context

12. Q2 witnessed the initial efforts of top Government personnel in socio-economic management. The socio-economic targets were not adjusted, despite adverse contextual changes since the beginning of 2016. More importantly, the Government re-affirmed priorities in macroeconomic stabilization, and microeconomic reforms for enhanced economic growth. Determination in this policy direction helped maintain and build macroeconomic policy space to cope with future shocks (if any), as well as focus on strengthening fundamentals for more robust economic growth in the medium and long-term.

13. As the first highlight, the new Government renewed efforts in creating favorable business environment, with fewer unnecessary barriers for improving competitive efficiency in the market. For consecutive weeks, the Government

has directly discussed and directed the review of investment and business conditions for removal in line with the Investment Law and Enterprise Law. The review was implemented strictly to ensure regulatory quality (especially the replacing Decrees), as well as avoid the simple transformation of Circulars into Decrees. Notably, the review process has for the first time been implemented comprehensively, with active participation of the business community and direct dialogue/official documents between enterprises and managerial agencies.

14. The Government also enlivened business environment reforms with the series of Resolutions 19. Resolution 19/NQ-CP dated 18 March 2014 set out the targets of attaining average level of ASEAN-6 by 2015 through 6 indicators of business environment and Resolution 19/NQ-CP on 12 March 2015 set out the targets of achieving average level of ASEAN-6 by 2016 through 10 indicators. After two years of implementation, the domestic investment-business environment was improved; competitiveness was increased and acknowledged by international organizations.[16] The business community highly appreciated[17] and were more optimistic about the improvement of investment and business environment and competitiveness by the Government. Some Ministries, agencies and provinces such as Ministry of Finance, Ministry of Planning and Investment, Ministry of Agriculture and Rural Development, Social Insurance of Vietnam, Vietnam Electricity, Vietnam Chamber of Commerce and Industry, Ho Chi Minh City and some other provinces actively conducted, supervised and monitored the implementation of business environment reforms, thereby leading to improvements of business environment scores and rankings.

15. To continue the reform of business environment, facilitating the production and business activities, on 28 April 2016, the Government issued Resolution 19/NQ-CP on tasks and key solutions for improving business environment, strengthening national competitiveness in 2016-2017, and direction to 2020. The Resolution determined the targets of improving business environment in both scores and ranking, including:

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[16] According to Global Competitiveness Report in 2015-2016 (published in September 2015) of the World Economic Forum, the competitiveness of Vietnam had significantly improved as compared to 2014, increasing by 12 places (from the ranking of 68/144 to 56/140). Vietnam's ranking was continuously improved since 2012 and the year 2015 witnessed the fastest improvement. Nevertheless, there was still big gap in most pillars (indices) of Vietnam to other ASEAN members. Vietnam's competitiveness ranked 6th after 5 ASEAN members states, including Singapore (ranked 2nd), Malaysia (18th), Thailand (32nd), Indonesia (37th) and the Philippines (47th), and was listed as the first half of the ranking.

In terms of business environment, the country's ranking (according to Doing Business 2016 Report of the World Bank, published in October 2015) increased 3 places in 2015, from 93 to 90/189 economies, with the improvement by 1.75 percentage points. Comparing with ASEAN 4, in 2015, Vietnam was registered as having more reforms, there was an increase in and having better the ranking of business environment (better ranking of 5/10 sectors); while 3 other ASEAN countries, including Malaysia, Philippines and Thailand were at lower ranking and Singapore still ranks first globally.

[17] Results from the survey of business associations and cooperatives alliance (coordinated supervision program of six stakeholders, including Fatherland Front, Ministry of Finance, VCCI, Vietnam Cooperatives Alliance, SME Association, Vietnam Young Enterprises Association for the implementation of Resolution 19 in taxation and customs, published in December 2015) showed that there were three positive-ranking indicators of Starting a business (84%); Paying taxes (75%); and Customs (68%).

a. By the end of 2016, the business environment indicators at least achieve the average of ASEAN-4 (Table 2). The Resolution also set out the target of comprehensive reforms of business conditions, specialized management of exported and imported goods in compliance with international practices, changing to post-inspection; electronization of procedures, connecting and sharing information among agencies, organizations; and establishing the supporting mechanism for start-ups.

Table 2: Targets of improving business environment indicators by the end of 2016

		Vietnam, current ranking	Targeted ranking of Resolution by end of 2016
1	Starting a business (ranking)	119	**71**
2	Dealing with construction permits (time, day)	166	**77**
3	Getting electricity (Time, day)	59	**59**
4	Registering property (time, day)	57.5	**14**
5	**Getting credit (WEF raking)**	**88**	**30**
6	Protecting investors (ranking)	122	**50**
7	Paying taxes and social insurance (time)	770	**168**
8	Trading across borders		
	Time for export procedures (hour)	147	**56**
	Time for import procedures (hour)	177	**73**
9	Enforcing contracts (time, day)	400	**200**
10	Resolving insolvency (time, year)	5.0	**2**

b. Maintaining the average level of ASEAN-4 by 2017 through indicators evaluated by the World Bank; and trying to achieve the average level of ASEAN-4 in some competitiveness indices evaluated by World Economic Forum (Table 3).

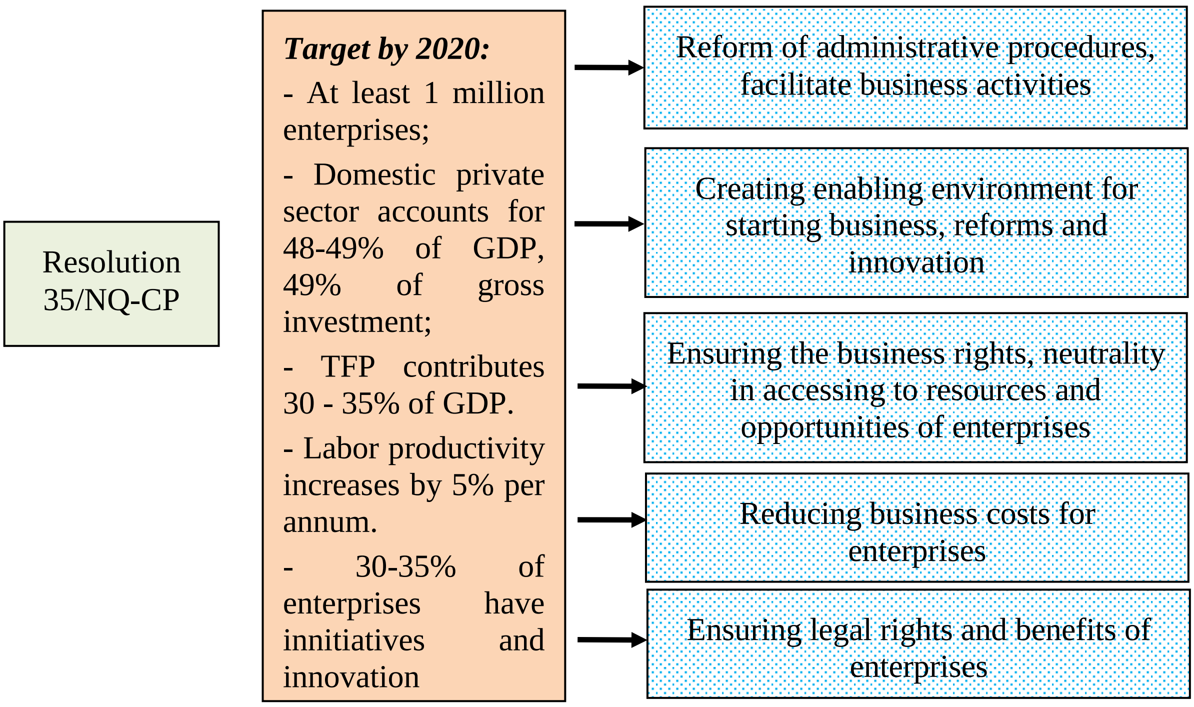
Table 3: Target of selected competitiveness indices by end of 2017

		Current ranking (out of 140 economies)	Targeted ranking of Resolution 19 by end of 2017
1	Effectiveness of competition policy Improving competition policy and enhancing goods market efficiency and competitive neutrality.	77	**Top 50**
2	Restricting non-tariff measures	100	**Top 40**
3	Ensuring flexible salary	67	**Top 60**
4	Productivity, ability to retain and attract talent	About 70-80	**Top 40**
5	Availability of financial services	About 100	**Top 50**

c. By 2020, some targets of business environment and competitiveness achieve the average level of ASEAN-3, including: Starting a business indicator: top 40; dealing with construction permits and related procedures: less than 70 days; Getting electricity for medium voltage: less than 33 days; Registering property, usage of property: less than 10 days; Protecting minority investors: top 30; paying taxes: 110 hours/year; paying social insurance: 45 hour/year; clearance time for trading across border: less than 36 hours for export and 41 hours for import; getting credit: top 30; enforcing contracts: less than 200 days; and resolving insolvency: maximum 20 months.

16. Resolution 35/NQ-CP of the Government, issued on 16 May 2016, was one of the important steps in systematize policy framework for supporting the enterprise development. The enforcement of the Resolution complied with various principles; yet unlike other resolutions, these principles were new and directly related to the interaction between managerial agencies and enterprises. For examples, the State protects the legitimate property rights and freedom in doing business of the people and enterprises within the regulatory framework, or the State ensures equality for all enterprises, notwithstanding economic types, economic actors in accessing to resources such as capital, natural resources, land, etc. and in business – investment activities, etc. After the issuance of Resolution 35/NQ-CP, many ministries and agencies had promulgated their individual action plans.

Figure 4: Summary of Resolution 35/NQ-CP



17. In addition to institutional improvement, the Government directly acted to facilitate business and production of enterprises. The most prominent and direct activity was the recent instruction of identifying reasons and addressing environmental consequences at Formosa industrial park. Besides, the Government firmly decided to align some behaviors of local authorities which directly infringed the freedom of business. The awareness, handling solutions and consensus in dealing with arising problems in Q2 was prompt and well-

structured. This lays the initial foundation in re-establishing “rules of law”, thereby enlivening the institutional reforms.

18. Limitations and difficulties persisted in the recent socio-economic management and business environment reforms. Such limitations and difficulties include the followings:

    a. Some Ministries, agencies and provinces did not actively implement reforms; administrative procedures remained complicated and troublesome. Thus, although investment and business environment was improved, ranking and scores were still low. Some indicators were below the expectation of Resolutions, including dealing with construction permits, registering property, trading across borders, resolving insolvency, etc, which were far below the average level of ASEAN-6 and ASEAN-4.

    b. Lack of a long-term vision with specific priorities for sustainable development. The policies are not and should not be restricted to the short-term issues in the next 1-2 years; instead, they should target the issues of environments, labor, etc. related to economic activities in the longer term. In the absence of such specific priorities, the Government might encounter some arising issues at some later stage. Under various circumstances, the costs for dealing with those issues (including time, finance and human resource) might be larger than finalizing and/or enhancing effectiveness of implementation since the beginning.

    c. Balancing the policy objectives was not easy, and is actually becoming more challenging. Consensus in phasing out unreasonable investment-business conditions has only been a matter of principle. Building a common understanding of the threshold that differentiates reasonable and unreasonable conditions is no easy task, due to: (i) the differential awareness of specialized management; (ii) difference between sectoral benefits and those for the economy/business community; and (iii) the mindset against losing management power of state agencies. To another extent, facilitating the early entry of enterprises may require shortening period for economic, social and environmental appraisal; however, the future risks and/or consequences can be bigger in the absence of matching supervision capability and enforcement mechanism.

II. MACROECONOMIC PERFORMANCE AND OUTLOOK

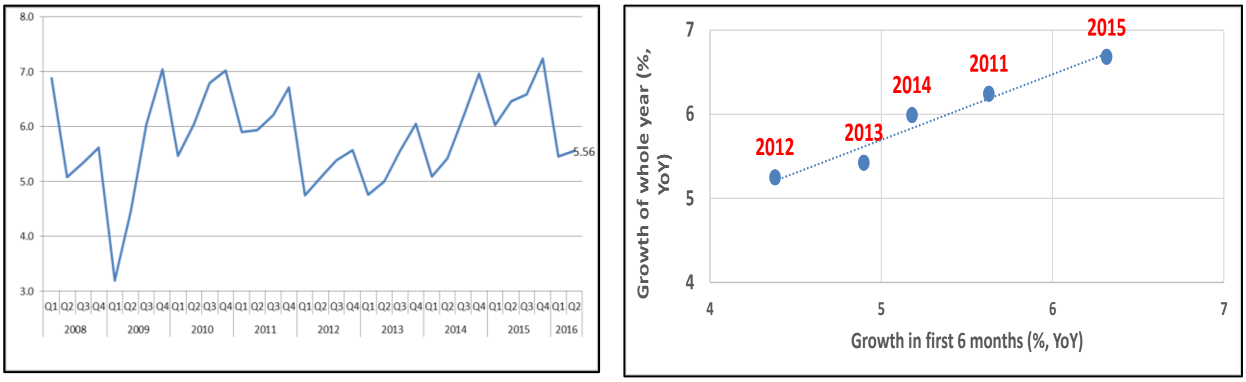
1. *Macroeconomic performance in Q2/2016*

1.1. Real economy

19. Economic growth was yet to regain recovery. GDP grew by 5.57% in Q2/2016 (YoY).[18] This figure was slightly higher than that of Q1/2016 and Q2s of 2012-2014. Still, economic growth in Q2/2016 was below that in Q2/2015 (Figure 5). In the first 6 months, GDP growth reached 5.52%, or 0.72 percentage points lower than that for the first half of 2015. The growth target for 2016 (at 6.7%, similar to that of 2015) becomes almost unattainable.

Figure 5: GDP growth rate

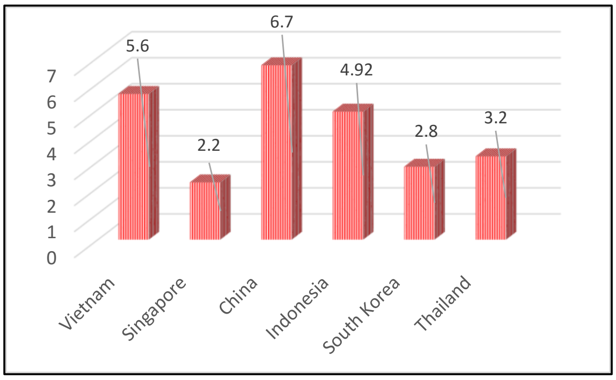
Unit: %



Source: General Statistics Office (GSO).

20. Vietnam's GDP growth remained higher than some countries. In Q2, growth figure of Vietnam was more rapid than those of Singapore, Indonesia and Thailand. However, Vietnam still grew more slowly than China, despite the latter's lowest rate recently. The slow recovery of global economy, in the context of further and deeper economic integration, also had impacts on economic prospects of Vietnam.

Figure 6: Economic growth for Q2 in some selected countries



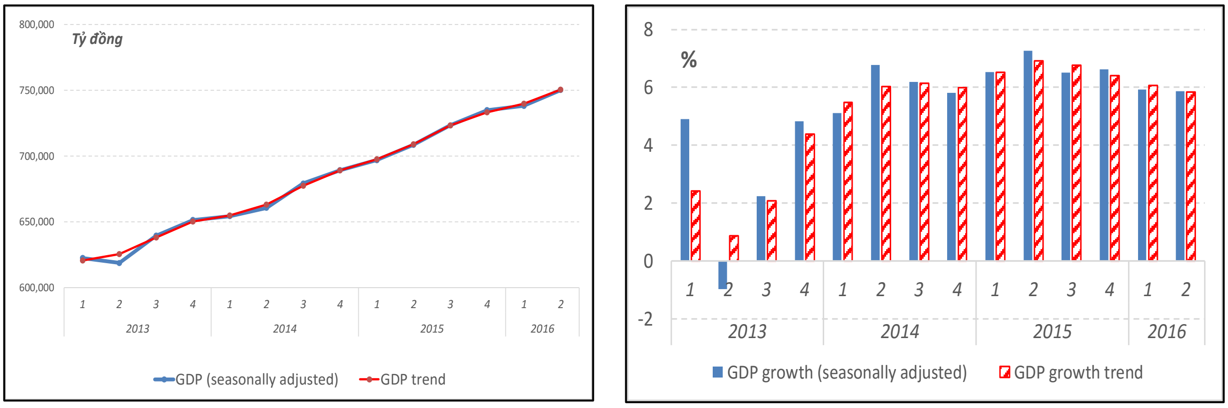
Source: Tradingeconomics.com

Note: Q1 data for Korea and Thailand.

21. Actual GDP was negligibly improved relative to potential level (Figure 7). Even potential (seasonally adjusted) growth increased slowly, or was on the decreasing trend in some recent quarters. As an implication, the recent microeconomic reforms have not yet helped significantly upgrade the overall production capacity.

[18] In Section II, growth was on year-on-year basis, except otherwise stated.

Figure 7: GDP performance relative to medium trend

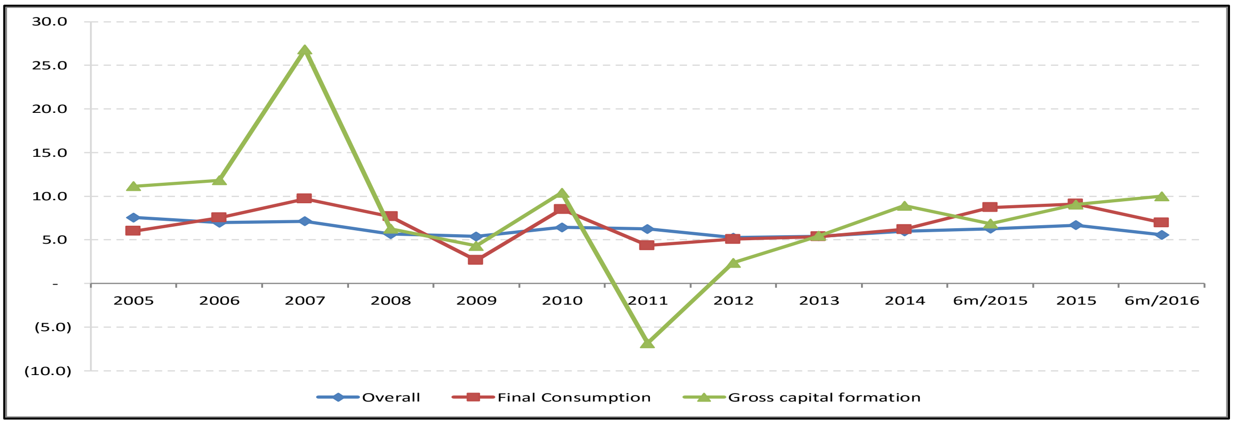


Source: Authors' calculation.

22. Gross capital formation and final consumption significantly induced overall GDP growth in this quarter (Figure 8). In the first 6 months, final consumption increased by 6.98%, contributing 5.09 percentage points to overall growth. Gross capital formation went up by 10%, contributing 2.65 percentage points. However, growth of final consumption and gross capital formation induced an increase in imports. Deficit of goods and services trade balance led to a decrease of overall growth level by 2.22 percentage points.

Figure 8: Growth rates of gross capital formation and final consumption, 2005-6m/2016

Unit: %



Source: GSO.

23. Growth of industry and construction attained 7.61% in Q2. This rate was 0.9 percentage point higher than Q1, but much slower than 2015[19] (Figure 9). In the first 6 months of 2016, the value-added of this sector rose by 6.82%, significantly below the corresponding rate of 9.66% in the first half of 2015.

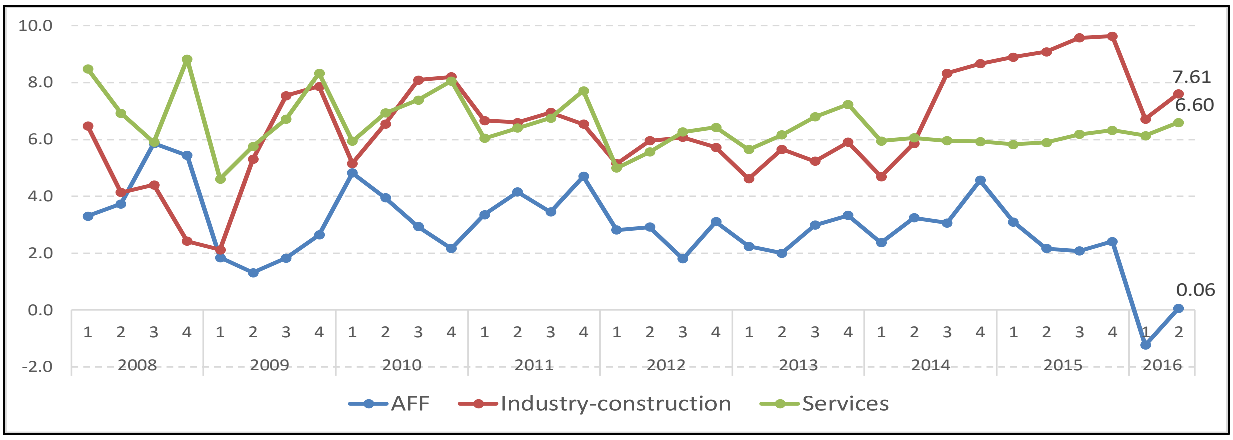
24. Manufacturing sector grew by 10.1% in the first half of 2015, i.e. roughly the same pace as the first half of 2015. Production and distribution of electricity, water supply and waste management and treatment experienced higher growth, with respective figures of 11.7% and 8.1%. However, mining and quarrying

[19] In 2015, the growth rate of industry-construction sector was 8.9% in Q1; 9.1% in Q2; 9.6% in Q3 and 9.64% in Q4.

sub-sector contracted sharply (by 2.2%[20]), leading to the overall decrease of industry sector. Thus, Vietnam should not and could not rely further on mining and quarrying sub-sector for promoting industry sector in particular and overall economic growth in general.

Figure 9: GDP growth by sector

Unit: %

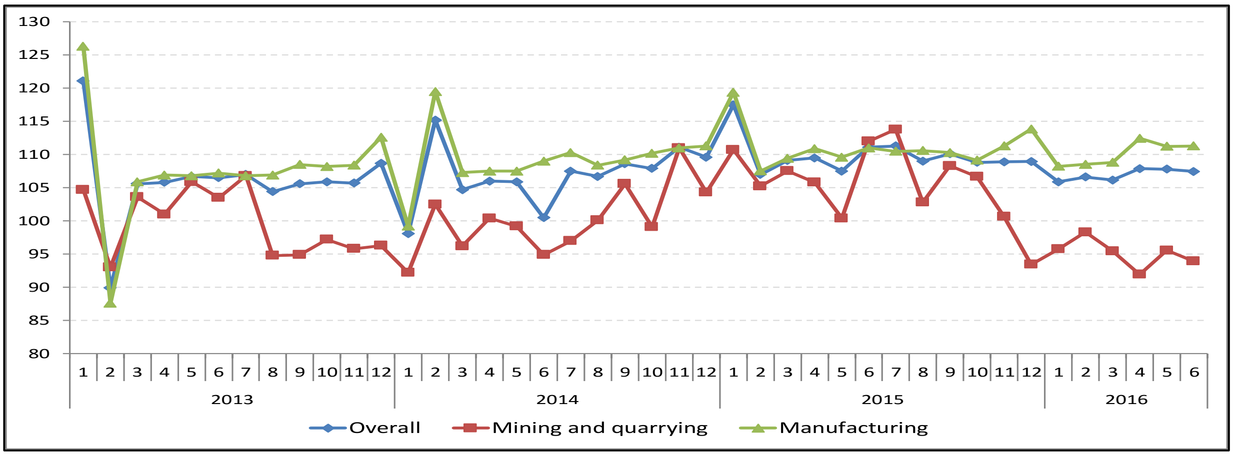


Source: GSO.

25. The Index of Industrial Production (IIP) rose by 7.5% in the first 6 months of 2016, significantly lower than in the first half of 2015 (9.7%). The growth rates for Q1 and Q2 were 7.6% and 7.5% in Q1 and Q2 respectively. The growth of IIP was quite stable in main sub-sectors, including (i) production and distribution of electricity; (ii) manufacturing; and (iii) water supply, waste management and treatment (Figure 10).

Figure 10: Index of Industrial Production, January 2013-June 2016

Unit: %



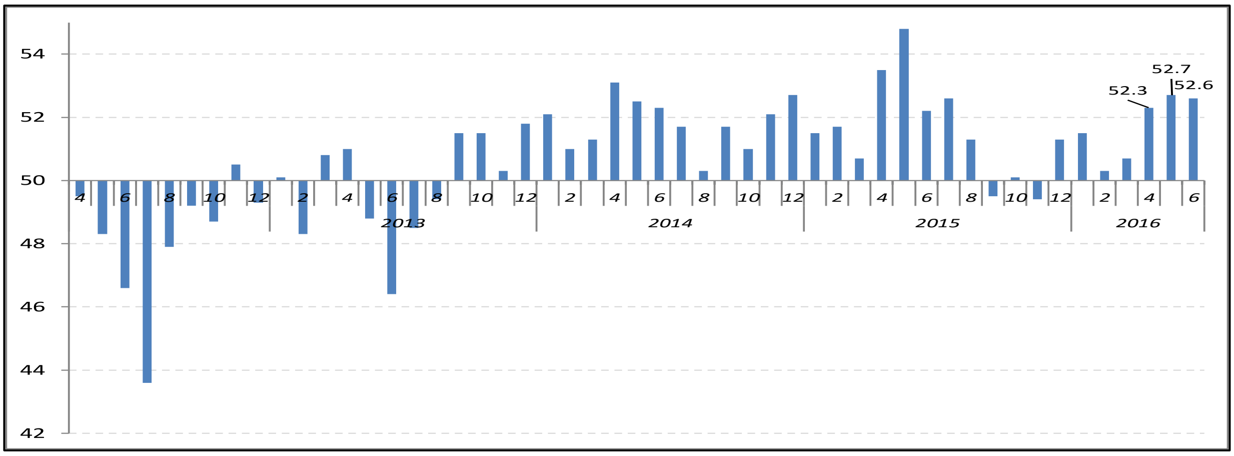
Source: GSO.

26. The stability of manufacturing sub-sector was also reflected through the index of sales. In the first 5 months of 2016, sales of manufacturing products increased by 8.8%; inventory index was up by 9% as at 1 June 2016 (lower than the rate of 11.8% as of 1 June 2015).

[20] Meanwhile, the mining and quarrying sub-sector grew by 8.5% in the first 6 months of 2015.

27. Higher consumption and investment demand helped prevent the industrial downturn in the first half of 2016. PMI was high and stable throughout Q2 (Figure 11). This can be attributed to: (i) gradually improved domestic business conditions; (ii) business and investors' confidence on the prospects of economic recovery[21]; (iii) increasing orders (both domestically and export)[22]; and (iv) slightly fall of production costs.[23]

Figure 11: Purchasing Manager Index, 2012-2016



Source: Markit, HSBC.

Note: PMI=50 means no month-on-month change

28. The agriculture-forestry and fishery (AFF) experienced some positive, though not sizeable, growth in Q2. The value-added of this sector went up by 0.06% in Q2. For the first 6 months of 2016, still, the overall value-added of AFF fell by 0.18% (the fall was by 1.23% in Q1). The gross output of AFF decreased by 0.1% (YoY), contrary to the positive changes during 2012-2015.[24] AFF activities in the first 6 months were constrained by: (i) unfavorable weather conditions, including drought and sanitization in Mekong River Delta; (ii) lower sales and prices of some commodities in international market;[25] and (iii) increase in input prices for agriculture[26].

29. The value-added of services sector grew by 6.6% in Q2. For the first 6 months of 2016, services sector growth attained 6.35% - the highest since 2012.[27] Some sub-sectors experienced high growth, such as wholesale and retail trade (up by

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[21] More analysis in the Survey on business tendency by GSO.

[22] PMI report for manufacturing sub-sector in Vietnam showed that the quantity of orders (including export orders) increased most rapidly in Q2 (within the span of last 12 months), "*Vietnam's manufacturing ... higher growth of output*" [authors' translation from Vietnamese].

[23] In Q2, the index of material for industrial manufacturing decreased by 0.09% as compared to Q1 and by YoY.

[24] The corresponding increases in the first 6 months of 2012, 2013, 2014 and 2015 were 2.81%, 2.53%, 3.4% and 2.36% respectively.

[25] For instance, the price of coffee fell by 15.6%, green pepper by 13.9% (YoY).

[26] For instance, price of raw materials went up by 3.33%; foodstuffs by 2.9% and agricultural products by 2.74%. In general, the price of inputs and materials for AFF increased by 0.94% in Q2 (as compared to Q1).

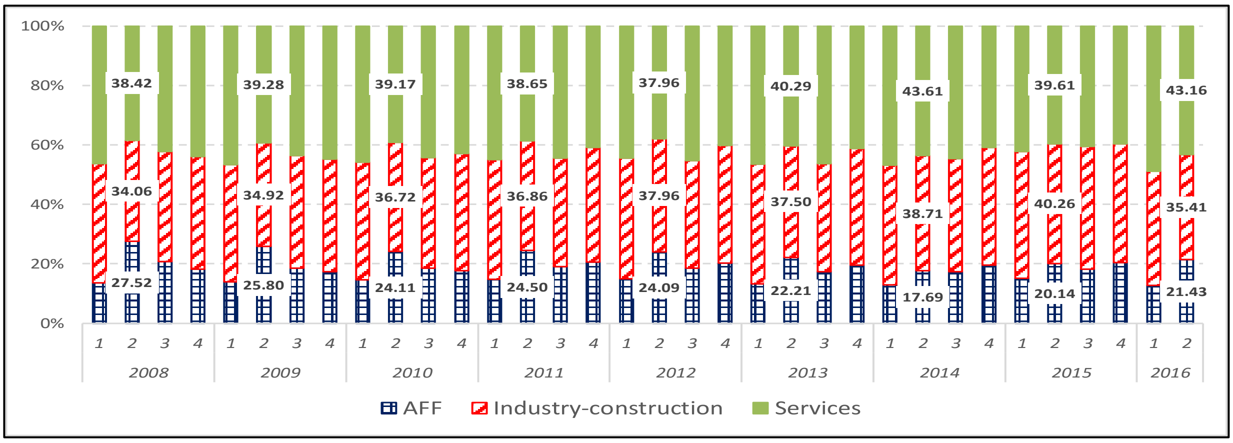
[27] Value-added growth of services sector in the first 6 months of selected years: 6.11% in 2012; 6.13% in 2013; 5.82% in 2014 and 5.86% in 2015.

8.1%); finance, banking and insurance (up by 6.1%); information and communication (up by 8.76%); healthcare and social assistance (up by 7.3%); arts, creation and entertainment (up by 7.2%); education and training (up by 7.15%). Real estate market showed signs of more robust recovery, growing at 3.77%, the peak since 2011.[28]

30. Economic structure depicted slight change in Q2/2016[29]. The share of AFF rose from previous quarter, reaching 21.43%. The share of services sector reached 43.61%, reflecting a slight increase on YoY basis. However, higher shares of AFF and services sector were mostly attributed to the slow-down of industry-construction sector. The industry-construction sector accounted for 35.41% of GDP in Q2/2016, down from 40.26% in Q2/2015 (Figure 12).

Figure 12: Quarterly GDP structure, 2008-Q2/2016

Unit: %



Source: GSO.

31. 30,374 enterprises were newly registered in Q2/2016, with total registered capital of VND 241.8 trillion. The growth of enterprises and capital was 16.6% and 41.2% respectively[30]. The number of inactive enterprises (including those registering inactive status or temporarily stopping before closing tax code or without registration) fell by 16% in Q2/2016 (Figure 9). However, enterprises still encountered difficulties. The number of dissolved enterprises increased by 20.7% (YoY, of which 93.1% were small scale enterprises with registered capital of less than VND 10 billion).

32. For the first 6 months of 2016, there were 54,501 newly registered enterprises, with total registered capital of VND 427.8 trillion, up by 20% in terms of the number of enterprises and up by 51.5% in terms of registered capital. The average registered capital per enterprise was VND 7.8 billion in the first 6 months, up by 26.2% on YoY basis. This movement was due to: (i) positive

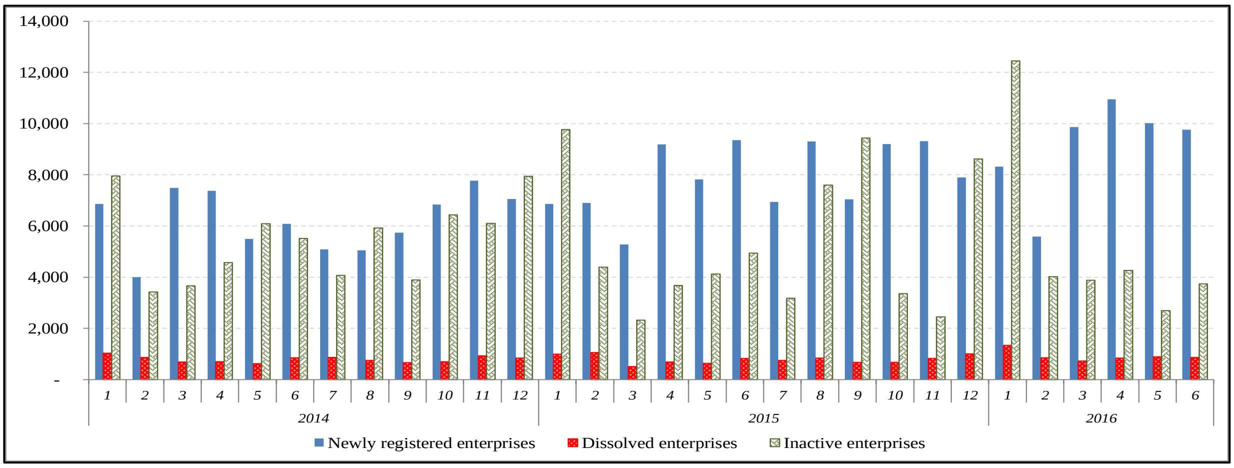
[28] The growth rate of real estate sector in the first 6 months of some selected years: 0.3% in 2011; -0.75% in 2012; 0.76% in 2013; 1.87% in 2014 and 2.35% in 2015.

[29] This analysis excludes the allocation of products taxes less subsidies on production in calculating the shares of sectors.

[30] In Q2/2015, the newly registered enterprises and capital increased by 39% and 28.8% respectively (YoY).

impacts of Enterprise Law, Investment Law and initial impacts of policy measures by the Government; and (ii) improved confidence of the business community and investors on economic prospects of Vietnam as well as opportunities from new generation FTAs.

Figure 13: Selected indicators of enterprises' performance, January 2014-June 2016



Source: Business Registration Agency, MPI.

33. The manufacturing enterprises had a positive assessment of production and business trend in Q2 (as compared to Q1). Some 41.8% of enterprises had better production and business in Q2 than in Q1/2016; 18.9% of enterprises still faced difficulties and 39.3% thought that production and business condition would be stable. Looking forward to next quarter, 47.7% of enterprises expected better tendency; 13.2% projected worse conditions and 39.1% of enterprises viewed on stable tendency. Enterprises were most optimistic about increasing production scale and orders (including export orders).

Figure 14: Business tendency (Q2/2016 as compared to Q1/2016)

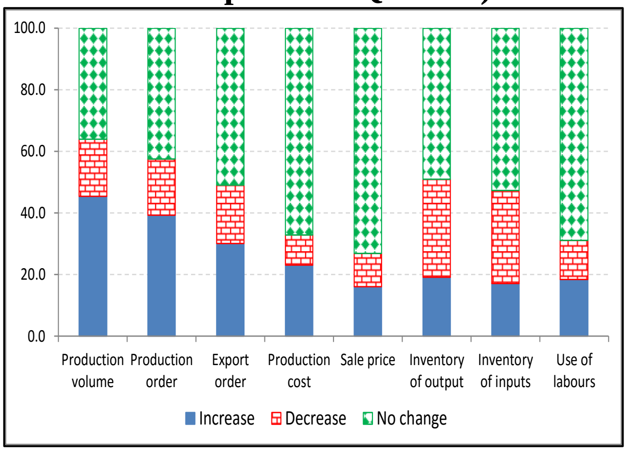
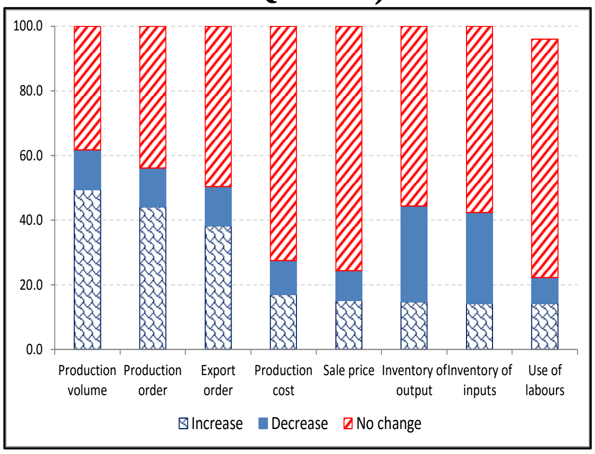


Figure 15: Business tendency (forecast for Q3/2016)



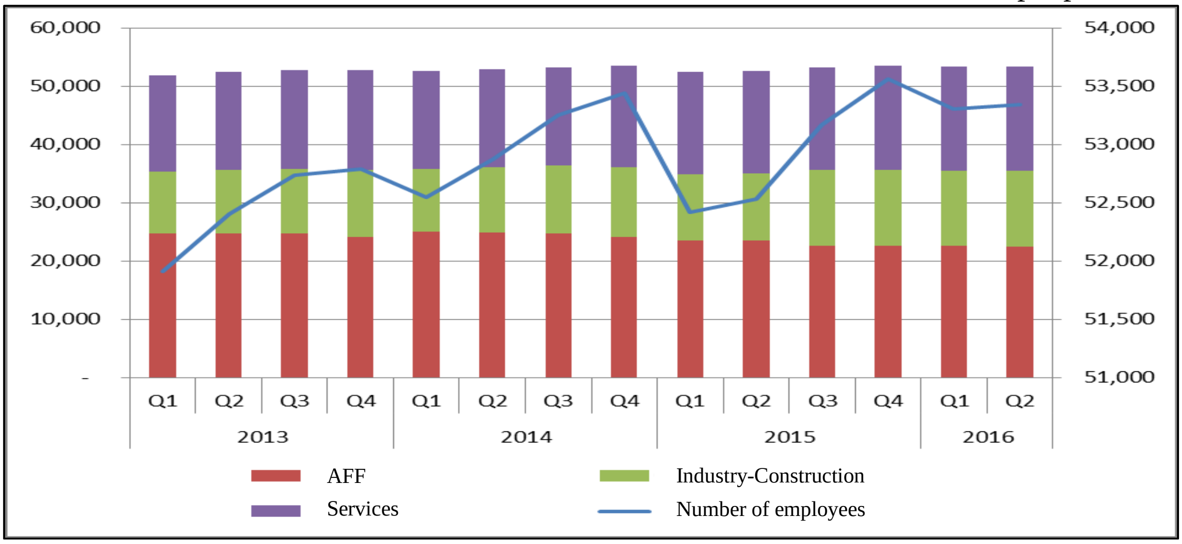
Source: GSO.

34. As of 1 July 2016, total labor force of the country was 54.36 million people, increasing by 1.22%. By the end of Q2/2016, total economically active labor force was 53.34 million people, up by 1.55%. Labor structure by economic

sector had almost no change. The share in total labor decreased slightly for AFF (to 42.2%), increased slightly for industry - construction (to 24.4%) and stayed unchanged for services sector (at 33.4%).

Figure 16: Economically active labor force by economic sector, Q1/2013-Q2/2016

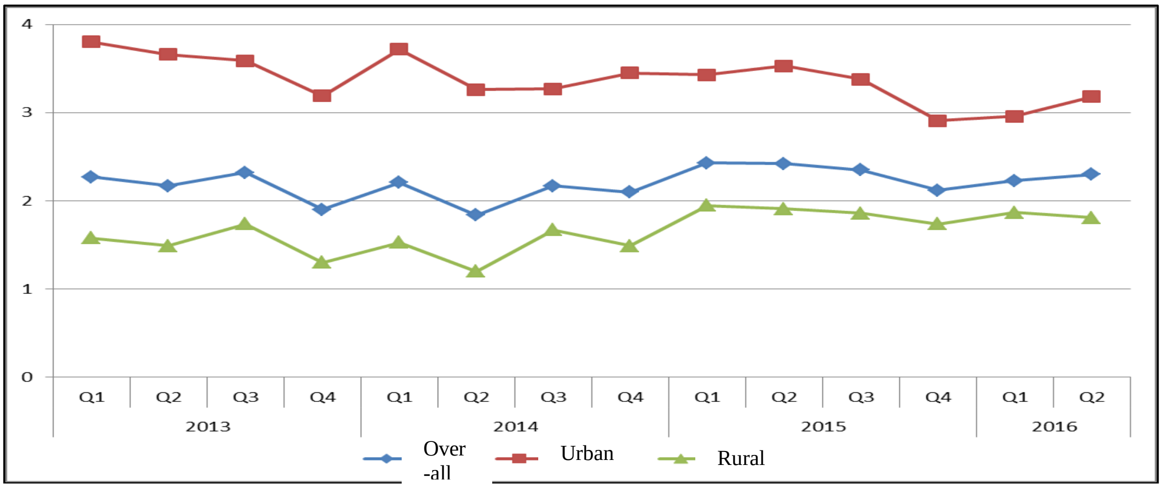
Unit: Thousand people



Source: GSO.

35. The working-age unemployment rate was 2.3% in Q2. For the first 6 months of 2016, the working-age unemployment rate was 2.27%, of which the urban figure was 3.18%; and that of rural area was 1.81% (Figure 17). The unemployment rate for working-age people in Q2/2016 declined from that in Q2/2015. As one of the concerns, however, unemployment rate in Q2/2016 was slightly higher than those for Q1/2016 and end of 2015. That is, the growth recovery was hardly robust, which led to fewer job opportunities for labor.

Figure 17: Unemployment rate (%)



Source: GSO.

36. One of the policy challenges is how to promote economic growth in the last 6 months and to lay a foundation for growth in the coming years. A recent proposal covers the increase of crude oil exploitation. This proposal was no new, and might root from the significant contribution of crude oil to economic

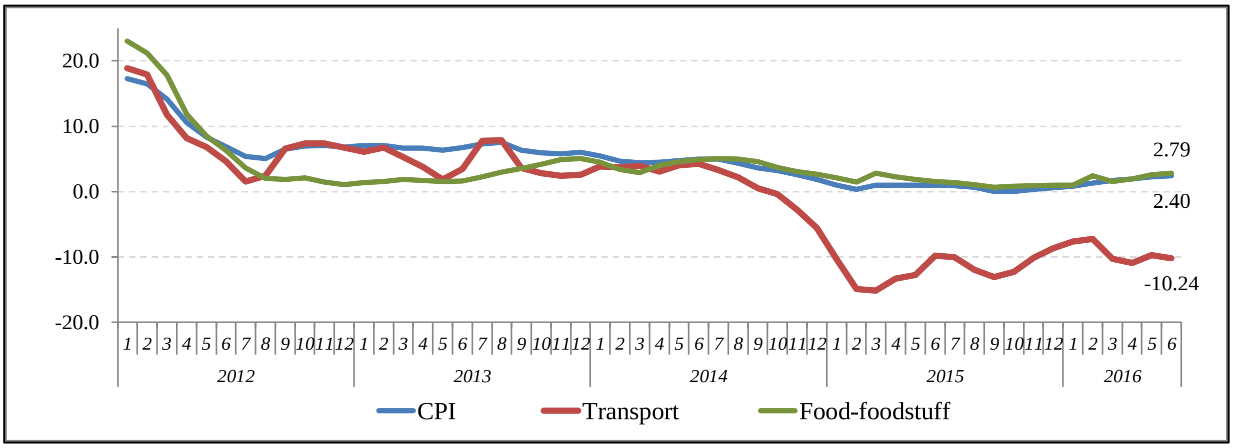
growth in 2015. However, this proposal hardly worked in the current context, due to: (i) relatively low crude oil price due to global economic downturn; and (ii) weaker momentum for economic restructuring towards less reliance on extraction of raw natural resources.

1.2. Inflation

37. Consumer Price Index (CPI) increased relatively rapidly in Q2. CPI rose by 2.4% in June (YoY) and by 2.35% compared to the end of 2015. CPI was up by 1.35% in Q2. Overall, CPI rose by 1.72% in the first 6 months of 2016 (YoY).

Figure 18: YoY inflation, 2011-2016

Unit: %



Source: GSO.

38. Core inflation increased by 1.80% in the first 6 months (YoY). The difference between core inflation and overall CPI showed that rapid growth rate of CPI was mainly attributed to the price increases for goods and services that are under the control of the State, including petrol, healthcare services and education.

39. Inflation in the first 6 months was mainly induced by cost-push factors, including: (i) the increase of petrol price in the international market which led to continuous upward adjustment of domestic price in Q2[31]; (ii) increase of the state-controlled price of goods and services (healthcare and education services); and (iii) adverse weather conditions and other shocks (drought and prolonged hot weather in the central and southern areas, massive dead fish in the central regions), resulting in higher price of food and foodstuff. However, efforts to stabilize exchange rate, lower (to a modest extent) interest rates, and keep the electricity price unchanged helped avoid piling up pressure on inflation. Meanwhile, consumption demand only increased slightly in Q2 for some goods and services (such as tourism, catering), with no material pressure on inflation.

40. There remains several risks and pressures on price management in the second half of 2016. *First*, the upward adjustment of state-controlled price of some

[31] Domestic petrol price was adjusted upward 6 times consecutively since March 21 with total increase of nearly 1,900 VND/liter (on April 5, April 20, May 5, May 20 and June 4); then lowered on June 20. The price of kerosene rose by 550 dong/liter on May 5 and by 351-398 dong/liter on June 20.

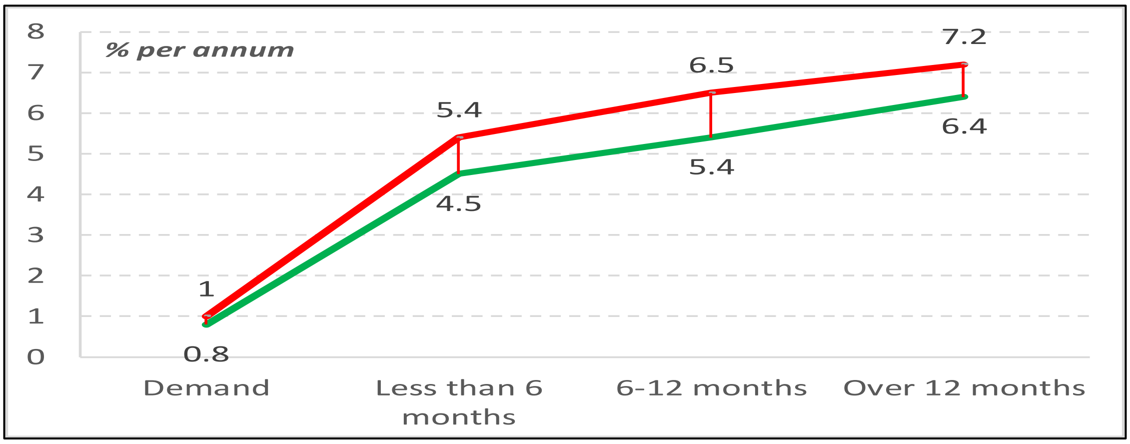
goods and services, in particular healthcare services and tuition fee[32], continues to be implemented in line with the roadmap, without flexibility. More importantly, such adjustments are short of accountability, while the citizens are yet to acknowledge the improvement of services quality. *Second*, domestic interest rates are hardly reduced because of large-scale issuance of Government bonds. *Third*, volatility of foreign capital flows and international financial market might lead to complicated responses by major economies (in terms of interest rate, exchange rate, etc.), which would in turn challenge the management of exchange rate and interest rate in Vietnam.

41. The price increase in the first 6 months (2.35%) was far below the target for the whole year (5%). Thus, the possibility to achieve inflation target was significant. However, inflation expectation for the last 6 months of 2016 and 2016 as a whole remains high level, about 6-7% (annualized). As the result, price management should be considered prudently, in particular the coordination with the implementation of other policy objectives (such as the issuance of Government bonds, upward adjustment of healthcare services price and tuition fee).

1.3. Monetary movement

42. At the end of June 2016, the VND-denominated deposit rate (for terms shorter than 6 months) was stable and below the ceiling imposed by the State Bank of Vietnam (SBV, Figure 19). As such, the actual VND-denominated deposit rates were almost unchanged since Q1/2015. Competition among commercial banks to mobilize deposits was relieved in Q2, which could be attributed to: (i) amendment of Circular No. 36/2014/TT-NHNN so that the roadmap becomes more relaxed; (ii) higher liquidity of the banking system while the SBV bought in more foreign currencies; and (iii) insignificant pressure from credit disbursement.

Figure 19: Popular VND-denominated deposit rates of commercial banks, end of June 2016



Source: SBV.

[32] According to the Joint circular No. 37/2015/TTLT-BYT-BTC dated October 29, 2015, the price of healthcare services will be adjusted upward 4 times in Q3 and Q4 of 2016, and once in Q1/2017. Pursuant to the Decree No. 86/2015/ND-CP, tuition fee will increase in September 2016.

43. USD-denominated deposit rates imposed on individuals and economic entities remained unchanged at 0% per annum. In the first 6 months, the SBV strictly enforced this USD-denominated deposit rate, instructed commercial banks to avoid paying positive effective interest rate to the depositors. USD-denominated lending rates in the inter-bank market declined slightly, especially for terms of shorter than 1 month (Table 4).

Table 4: Interbank USD-denominated lending rates

Unit: % per annum

	Over night	***1 week***	***2 weeks***	***1 month***	***3 months***	***6 months***
Week of 7-11/3	0.50	0.46	0.59	0.78	0.93	1.27
Week of 27/6-1/7	0.37	0.42	0.54	0.76	1.12	1.59

Source: SBV.

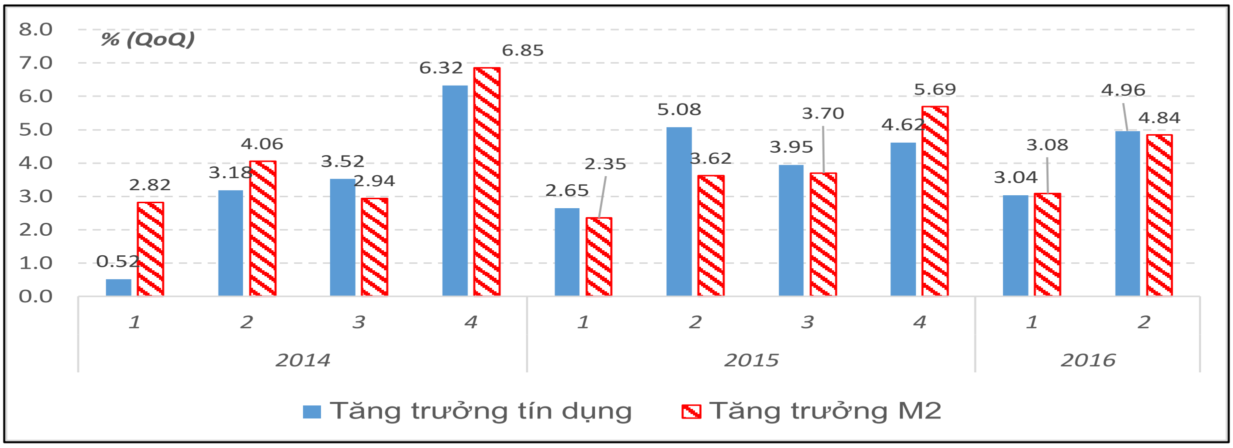
44. VND-denominated and USD-denominated lending rates went down only insignificantly in Q2. In April, some state-owned commercial banks actively lowered lending rates, though the decrease and scope were relatively modest. Some credit programs with preferential interest rate failed to work due to the shortage of funds.[33] The room for further reduction of lending rates (both USD-denominated and VND-denominated rates) is rather scarce due to: (i) the lack of efforts to reduce "credit fragmentation" across various credit programs;[34] (ii) the crowding out effects of Government bond issuance on private credit; and (iii) relatively high inflation expectation. In Q2, commercial banks were not exposed to ample risk of interest rate hike in the US. The post-Brexit fluctuation of USD and JPY did not affect USD-denominated lending rates.

45. Outstanding credit was estimated to grow by about 4.96% in Q2 (compared to the end of Q1), which significantly outpaced the figure for Q1 (3.04%). By the end of June, outstanding credit increased by about 8.16% compared to the end of 2015). YoY growth rate of outstanding credit only varied slightly between Q1 and Q2, which differed from previous years (Figure 20). The reasons included: (i) more rapid credit disbursement in Q1 due to the concern/rumor of the cease of foreign-currency denominated credit or the 30,000-trillion-dong stimulus package for social housing, etc.; (ii) increasing Government bond issuance and crowding out effects on credit; and (iii) lack of robust growth recovery which increased enterprises' caution in borrowing decisions.

[33] For instance, the stimulus package for social housing of Vietnam Bank for Social Policy applied the lending rate of 4.8% per annum (taking effect from the beginning of June to the end of December 2016).

[34] See Macroeconomic Report for Q3 of 2015.

Figure 20: YoY growth of outstanding credit and M2, 2014-2016

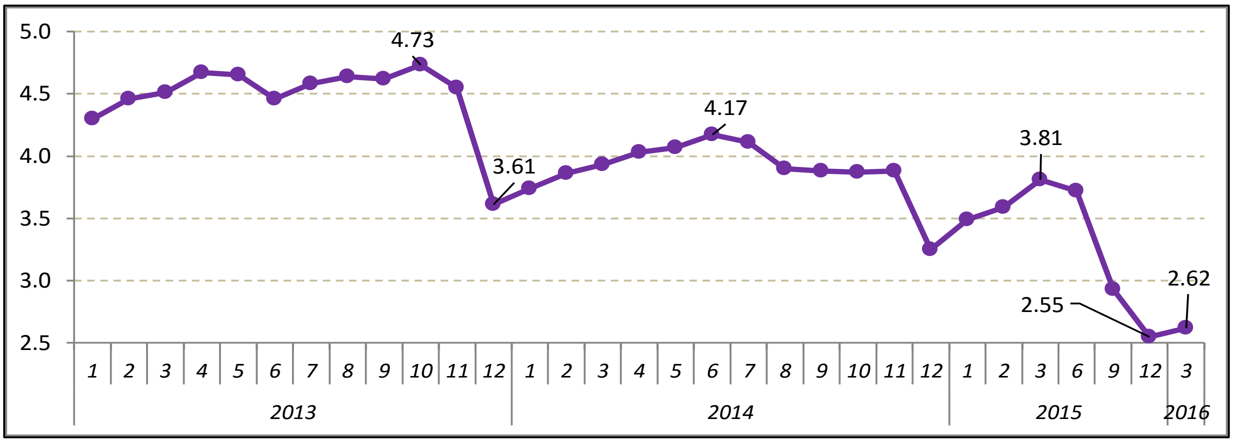


Source: Compilations from various sources.

46. Non-performing loans (NPL) were short of improvement. By the end of March, NPL ratio rose to 2.62% (from that of 2.55% by the end of 2015) (Figure 21). The purchase, selling and reduction of NPLs in Q2 exerted insignificant improvement in Q2 as well as in the first 6 months. Commercial banks were yet to develop plans to further address NPLs.

Figure 21: NPL ratio of credit institutions, 2013-2016

Unit: %



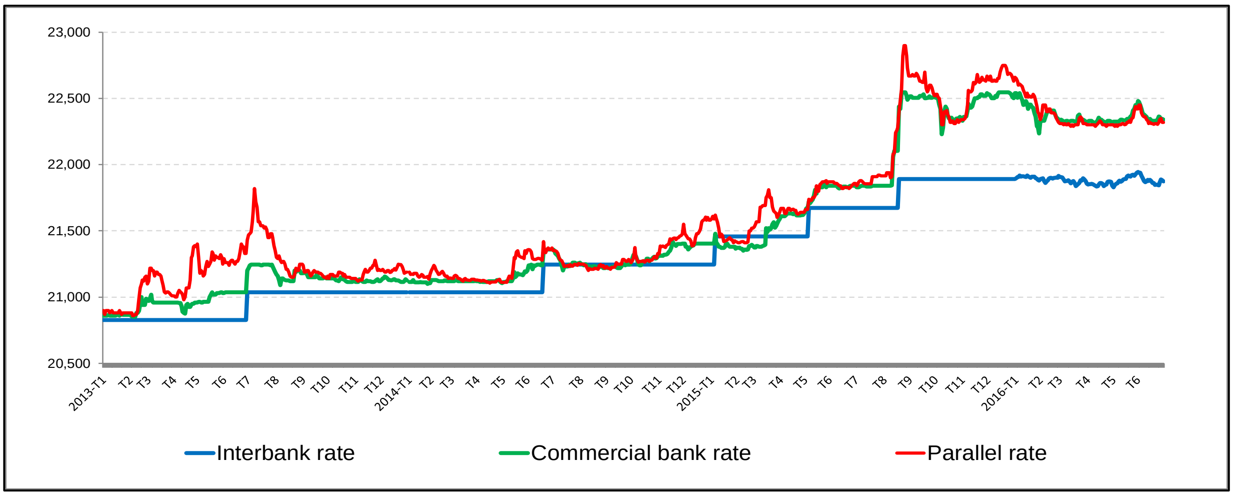
Source: SBV.

47. Total liquidity (M2) was estimated to grow by 4.84% in Q2 (compared to the end of Q1) and 8.07% in the first 6 months (relative to the end of 2015). The M2 growth rate in Q2/2016 outpaced than those in Q1/2016 and Q2s of 2014-2015 (Figure 20). Rapid growth of M2 hardly originated from the loosening of monetary policy to promote economic growth. Instead, extension of liquidity was aimed at assisting Government bond issuance and the purchase of foreign currencies to increase foreign reserves. However, given the core inflation of 1.8% in the first 6 months which was relatively closed to the target for 2016 (2%), the management of M2 should be more prudent in the coming months.

48. The management of VND/USD exchange rate was a remarkable success in the first 6 months (Figure 22). The central VND/USD rate was flexibly adjusted, with roughly equal numbers and magnitudes of increases and decreases, albeit

difficult to foresee (Figure 23). In general, the central rate was stable in Q2, except the rapid increase at the end of May. The average central rate of VND/USD exchange rate was 21,875 in Q2, i.e. less than Q1 (about 21,890). The exchange rate in the parallel market and commercial banks resembled no major volatility and stayed consistently below the permitted ceiling.

Figure 22: VND/USD exchange rate



Source: VNDirect.

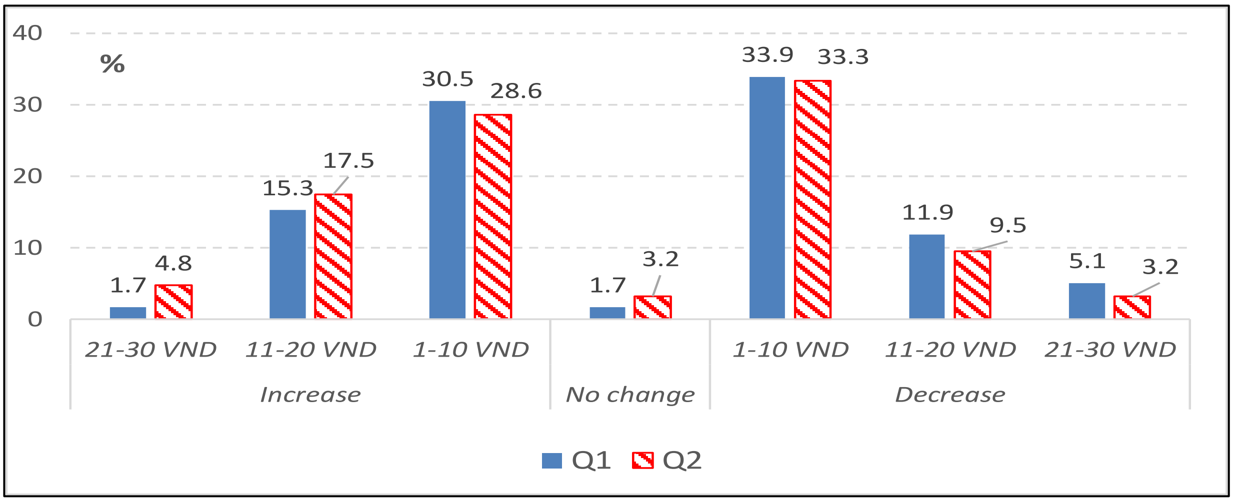
49. The foreign exchange market was under insignificant pressure in Q2. Exchange rate fluctuation in late May hardly reflected supply-demand imbalance in the market. The VND/USD exchange rate even showed no major fluctuation after Brexit though the exchange rates of JPY, EUR and GBP varied considerably. From management perspective, this was attributed to: (i) the shift to central exchange rate based on a basket of selected major foreign currencies instead of solely USD, which minimized the exchange rate management risks in the context of drastic and opposite variations of cross exchange rates; (ii) no rigid target for exchange rate policy as capital flows varied more rapidly and the reduction of interest rate was prioritized;[35] (iii) fixed USD-denominated deposit rate despite various recommendations to increase the deposit rate ceiling; and (iv) timely efforts to disseminate information and calm down the public during major events of the international foreign exchange/financial markets.

50. The management of central exchange rate in Q2 benefited from several factors. *First*, FED clearly signaled the delay of interest rate hike to boost the US economy and avoid further adverse impacts on the global financial market in the context of significant volatility. *Second*, similar to Q1, the capital withdrawal from developing and emerging economies was slowed down,[36] thereby relieving pressure from the balance of payment of Vietnam. *Third*, Brexit resulted in overshooting in the international financial market in only a short time, and the market was quickly stabilized. Brexit created insignificant direct impacts on the real economy of the EU and the United Kingdom. To

[35] "Impossible trinity": It is impossible to simultaneously implement fixed exchange rate, free capital flows and independent monetary policy (related to interest rate management).
[36] See Section 1 in Chapter I.

date, there have been few major economic policy responses by developed countries; thus, pressure on exchange rate management in Vietnam is modest.[37]

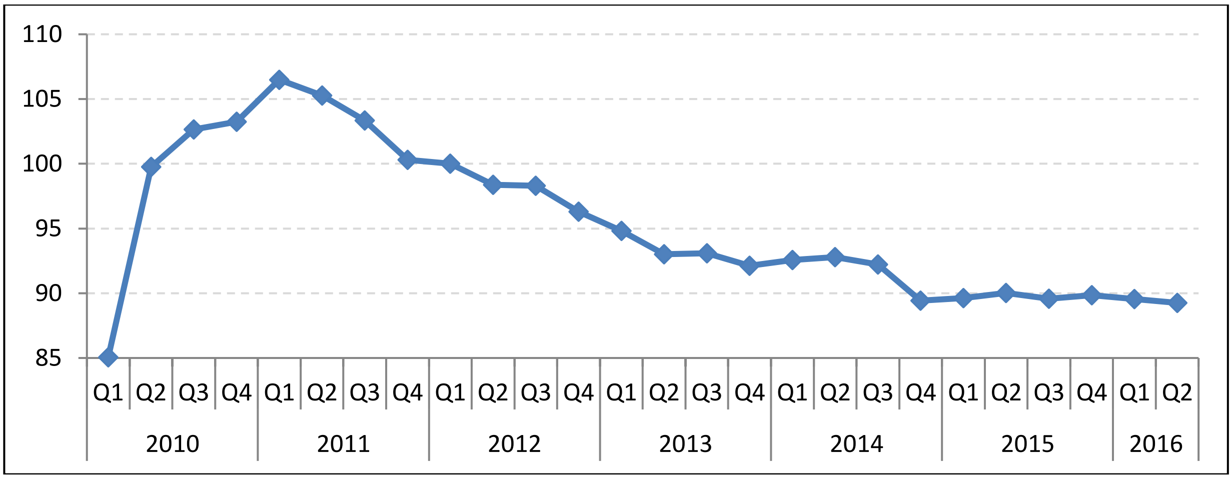
Figure 23: Adjustment frequency of central VND/USD exchange rate



Source: Authors' calculation.

51. Real Effective Exchange Rate (REER) of Vietnam went down by 0.34% in Q2 (compared to Q1/2016) and by 0.86% compared to 2015 (YoY). That is, Vietnamese goods became more expensive relative to foreign ones (Figure 24). This was noteworthy as some major currencies in the currency basket appreciated against USD in Q2: the exchange rate of JPY (against USD) fell by 6.5%; of EUR and CNY by 2.3% and 0.12%, respectively. As such, attempts to stabilize monetary policy in general and exchange rate in particular was inadequate to maintain competitiveness of Vietnam's goods because of high inflation in the domestic economy (mainly attributed to cost-push factors).

Figure 24: Real Effective Exchange Rate



Source: Authors' calculation.

Note: Q1/2012=100. REER was calculated using trade data with 20 biggest trading partners and CPI statistics. Data for Q1/2016 was estimated. A smaller value implies that Vietnamese goods are relatively more expensive than foreign ones.

[37] See Section 1.5 in Chapter II.

1.4. Investment

52. Gross investment was estimated to reach VND 341.7 trillion in Q2, rising by 12.9%. For the first 6 months, gross investment attained VND 618.2 trillion, increasing by 11.7% (YoY) and outpacing the growth rate of 9.4% in the first half of 2015. In real terms, gross investment grew by 9.6%.

Table 5: Gross investment, current prices

Unit: Trillion VND

	Plan for 2016	Q1/2016	Q2/2016	First 6 months of 2016	Growth rate of the first 6 months (YoY, %)
TOTAL	**1,540**	**276.5**	**341.7**	**618.2**	**11.7**
State budget investment	240	42.8	64.2	107.0	11.9
Government bonds	60	8.8	11.8	20.6	-17.3
State credit	75	12.1	14.9	27.0	6.3
Borrowings from other sources (by the State sector)	90	17.2	19.6	36.8	9.9
Investment by SOEs (Equity)	70	13.1	16.4	29.5	4.6
Investment by individuals and private sector	620	102.5	128.2	230.7	14.7
FDI	360	76.5	81.7	158.2	15.6
Other sources	25	3.5	4.9	8.4	9.1

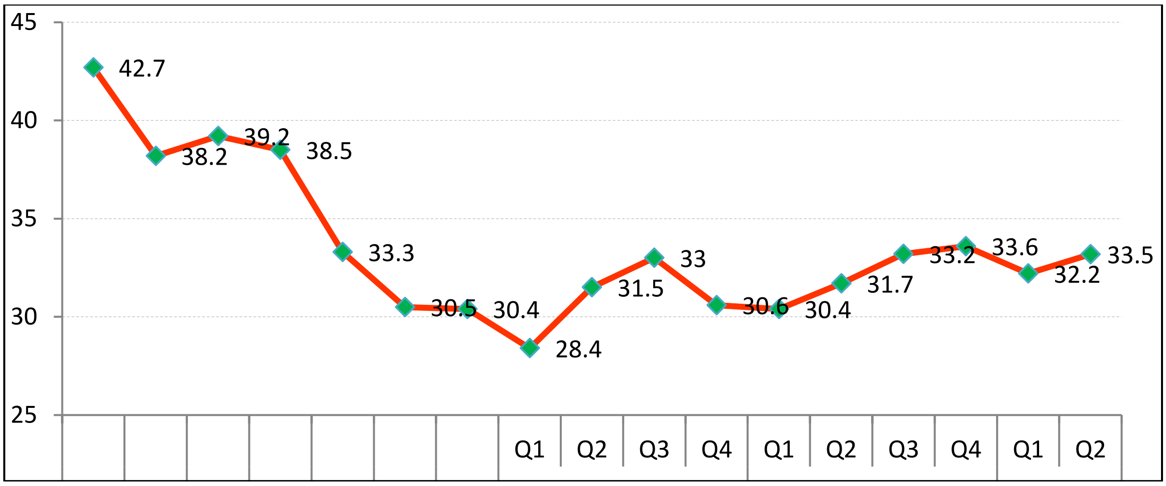
Source: GSO.

53. The investment to GDP ratio was 33.5% in Q2/2016, higher than in Q1/2016 and Q2s of 2014 and 2015 (YoY) (Figure 25). In general, investment disbursement of all sources in Q2 exceeded that in Q1. The private sector, domestic private sector-individuals and FDI sector were the biggest investment sources. The FDI sector had the highest growth rate of investment in the first 6 months (increasing by 15.6%), followed by the individual and private sector (by 14.7%). Investment disbursement by these two sectors were also the largest in absolute value (Table 5).

54. Investment disbursement was still smaller than expectation in the first 6 months of 2016, equivalent to only 40% of the plan for 2016 (Table 5). The disbursement of Government bonds attained 34.33% of 2016 plan, decreasing by 17.3%. The slow disbursement of public investment, including Government bonds, in the first half of 2016 could be attributed to: (i) limited capital sources as economic growth and state budget revenues were modest; (ii) poor disbursement of capital allocated for national targeted programs because of late approval and issuance of instructions/guidance; (iii) late assignment of capital investment plans by some ministries and provinces; (iv) Low regulatory quality over the appraisal and approval of project designs and budgeting; and (iv) "chronic" issues of the authorities over public investment projects, such as overlapping competence between investors and project management unit (which was not separated by legal documents).

Figure 25: Investment/GDP ratio

Unit: %

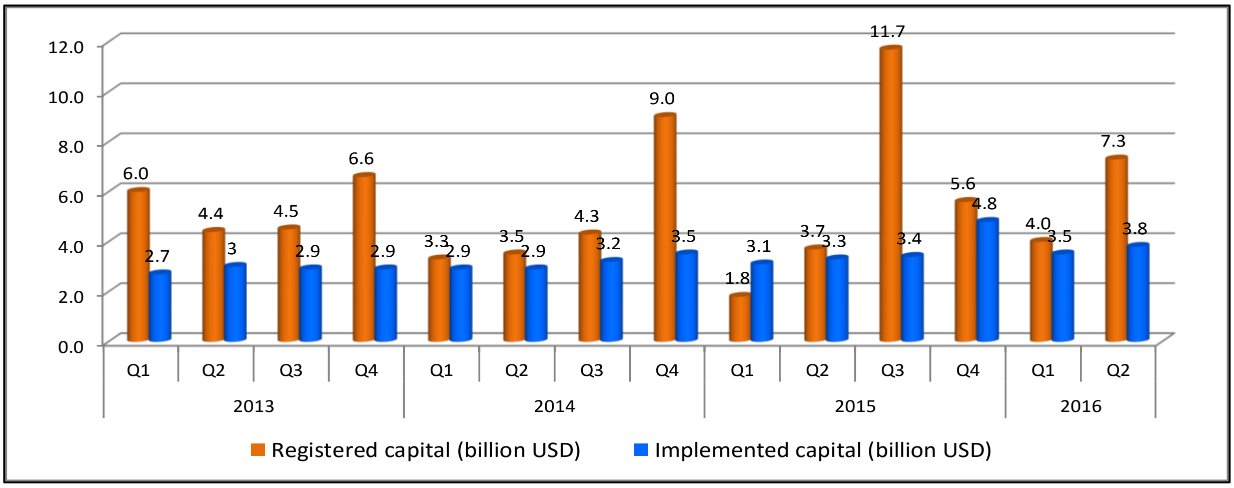


Source: GSO.

55. FDI attraction was an important achievement. In Q2, there were 672 newly-licensed FDI projects with total registered capital of about USD 4.7 billion. Total registered capital of newly-licensed and supplemented projects mounted to approximately USD 7.3 billion, which was doubled from that in Q2/2015 (Figure 26). In the first 6 months, registered capital of newly-licensed and supplemented projects attained USD 11.3 billion, increasing by 105.4%. Meanwhile, implemented FDI capital was USD 3.8 billion in Q2 and USD 7.25 billion in the first 6 months, up by 16.9% and 15.1%, respectively.

Figure 26: FDI attraction to Vietnam

Unit: Billion USD



Source: GSO.

56. By sector, manufacturing accounted for the largest share of total FDI attraction in the first 6 months, attaining nearly USD 8.1 billion (equivalent to 71.5% of total registered capital). The second and third biggest volumes of FDI capital were poured into real estates (USD 604.8 million, accounted for 5.3%) and professional, scientific and technological activities (USD 562.3 million, 5%).

57. The first 6 months witnessed a number of large FDI projects to Vietnam. Examples include the 1.5-billion-USD project of LG Display in Hai Phong, Samsung R&D project (with registered capital of USD 300 million), Tra Vinh windmill project phase II (USD 247.6 million), Midtown project in Ho Chi Minh City (USD 225.6 million), Taiwanese-funded project Dai Duong paper plant (USD 220 million), etc.

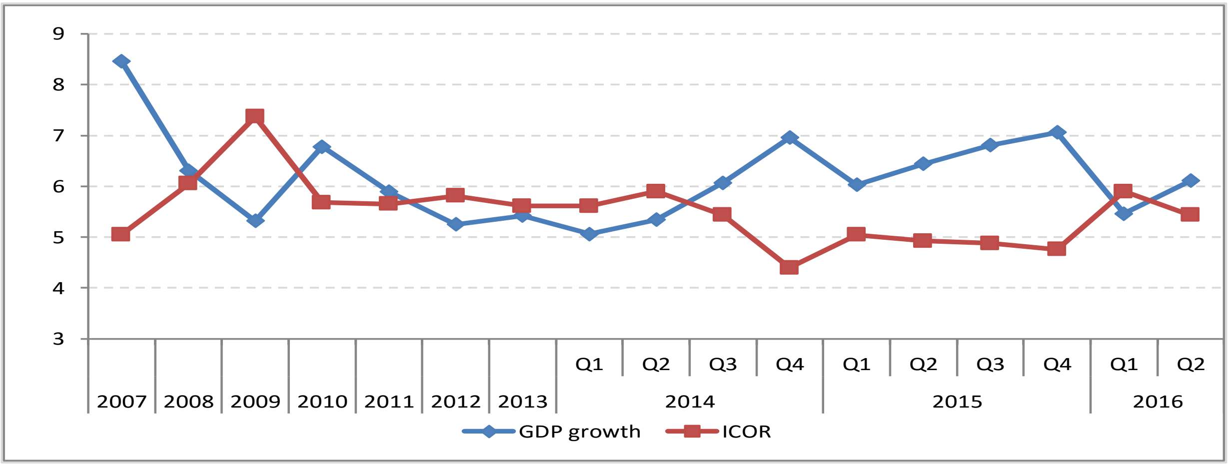
58. In the first 6 months, Korea and Singapore were the biggest investors to Vietnam with total registered capital of USD 3,132.4 million and USD 1,011.1 million, respectively, altogether accounting for more than 50% of total registered capital. Taiwan, Japan and Hong Kong followed with registered capital of USD 530.3 million, USD 496.4 million and USD 455.4 million, respectively, with total shares of 19.8% of total registered capital. As an implication, FDI from Asia region – where Vietnam is joining the value chain and has various FTAs – played an important role.

59. In terms of growth rate, the individual-private sector had investment growth rate of 14.7% in the first 6 months (higher than in the first half of 2015: 11.4%). Investment expansion from the individual-private sector could be attributed to: (i) improved expectation and confidence of investors on initial attempts of the Government to renew the business-investment environment, increase market entry and address unreasonable barriers; (ii) expectation of the business community on a loosening fiscal policy to promote investment as economic growth seems stagnant; and (iii) firms' preparedness ahead of potential business opportunities from a number of signed and pending international economic integration agreements of Vietnam, such as TPP, FTA with the EU, AEC, etc.

60. Investment by individual-private sector remained slower than initial expectation. In the first 6 months, disbursed capital of this sector attained only 37.2% of the plan for 2016. To a certain extent, the small implemented capital was attributed to sluggish economic growth expectation, and restructuring of enterprises (inactive, dissolved and newly-registered ones beyond the amendment of the Enterprise Law and Investment Law). However, other factors also constrained investment by individual-private sector, including: (i) difficulties in getting credit; (ii) credit fragmentation across various programs; and (iii) crowding out effects of Government bond issuance.

61. Since the beginning of 2016, investment efficiency tended to deteriorate (Figure 27). ICOR dropped to 5.6 in the first 6 months, and was at nearly 6 in Q1. This situation differed from the consecutive decline of ICOR during 2014-2015. As the result, investment efficiency could hardly be improved if the sole prioritized measure is to promote capital disbursement, in particular Government bonds, instead of focusing on disciplining public investment.

Figure 27: Investment efficiency



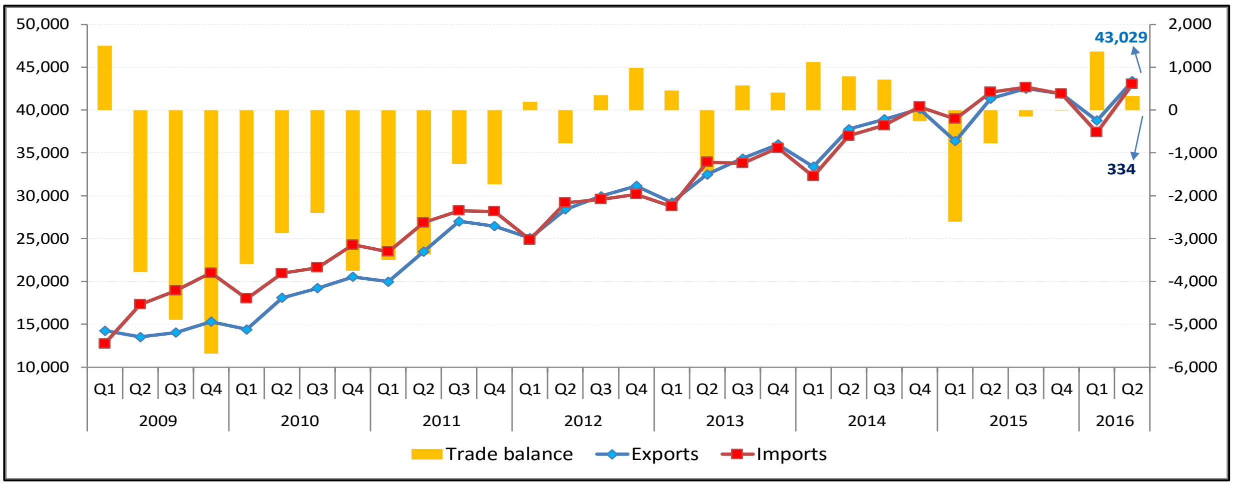
1.5. Trade

62. Exports in Q2 attained USD 43.4 billion, increasing by 4.9% (Figure 28). Notably, Vietnam did not benefit from export price (in USD) since it fell by 2.88% from Q2/2015 to Q2/2016. Excluding price factors, export quantity rose by 8.0% in the same period.

63. In the first 6 months, exports were valued at USD 82.1 billion, increasing by 5.7%. Export growth remained lower than the target for 2016 (about 10%). However, this growth figure still surpassed those in other export-oriented economies in Asia[38]. Besides, excluding the price factors, export volume increased by about 9.1% in the first half of 2016.

Figure 28: Exports, Imports and Trade Balance, 2009-2016

Unit: Million USD



Source: Authors' calculation.

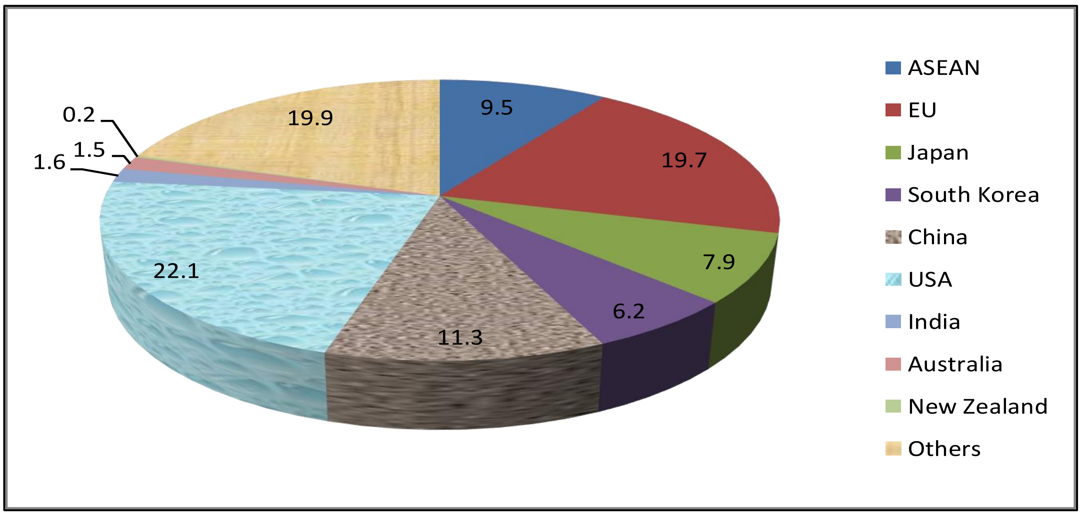
Note: Exports and imports are shown in the left-hand axis and trade balance is shown on the right-hand axis.

[38] For example, China's export growth dropped by 4.9% in June 2016. From 7/2015-6/2016, China's export growth only increased in 3/2016. Singapore's export growth fell quite dramatically in the first 4 months. Thailand's decreased by 8% and 4.4% in 4/2016 and 5/2016, respectively. Source: Tradingeconomics.com.

64. Export growth was mainly attributed to FDI sector. In Q2, export growth of FDI sector reached 7.35%, contributing 4.9 percentage points to overall export growth. In contrast, exports of domestic sector fell by 1.17%, decreasing overall export growth by 0.3 percentage points. For the first 6 months, export of FDI sector and domestic sector attained USD 57.3 billion and USD 24.8 billion, respectively.

65. Exports of some commodities grew relatively rapidly in Q2. Of which, agricultural products experienced high growth such as fruits and vegetables (up by 19.8%), cashew nut (up by 13.5%) and coffee (up by 33.4%). Some electronic products such as telephones, spare parts and machine and tools attained high growth rate of 9.5% and 19.8%, respectively.

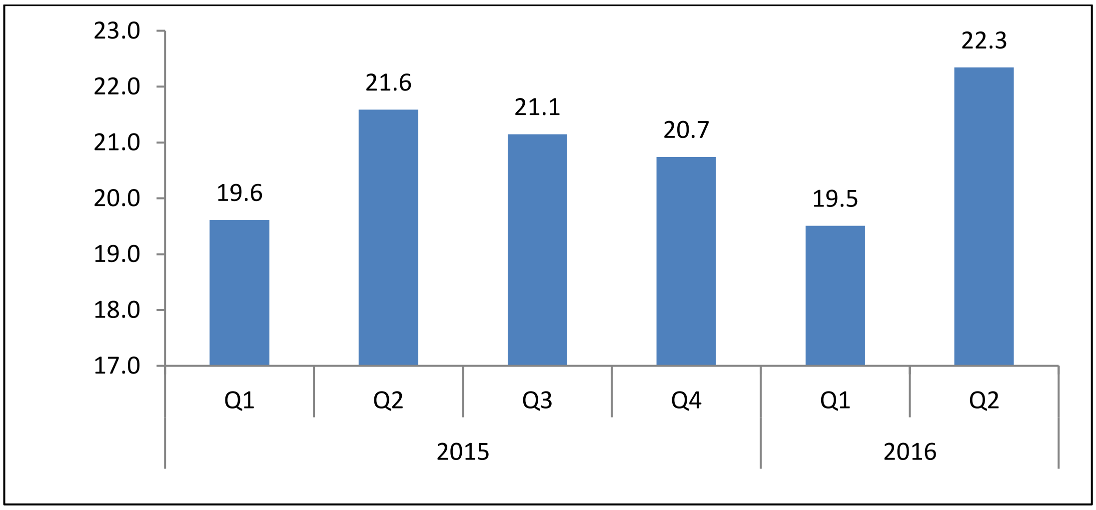
Figure 29: Exports to major trading partners, Q2/2016 (%)



Source: General Department of Customs.

66. The export structure hardly changed in Q2. The USA was the largest export market of Vietnam in Q2, reaching USD 9.6 billion, up by 10.7% and accounting for 22.1%. Other main export markets such as the EU (accounting for 19.7%), China (11.3%) and ASEAN (9.5%) followed (Figure 29).

Figure 30: Imports of capital goods (Billion USD)



Source: General Department of Customs.

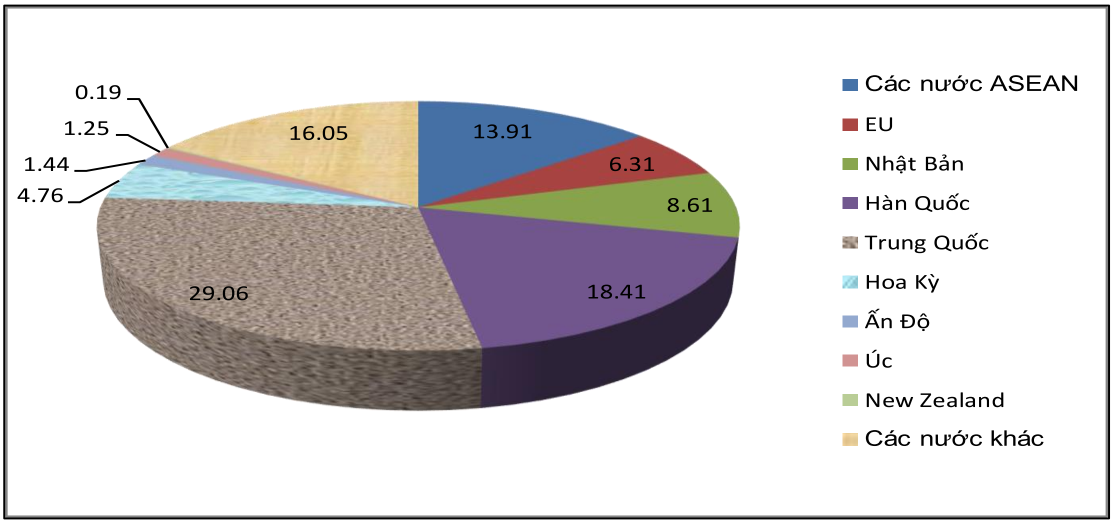
67. Imports were estimated at USD 43.0 billion in Q2, increasing by 2.2% (Figure 28). Of which, import value of the FDI sector was USD 24.6 billion, similar to Q2/2015. The import value of domestic sector amounted to USD 18.4 billion, increasing by 5.2%. The slow increase of import was attributed to: (i) slow export growth which reduced the demand of input material imports; (ii) slow recovery of the economic growth, leading to a fall in consumption demand for imports; (iii) decreasing import prices (by 6.7%); and (iv) restricting imports through technical measures.[39]

68. Import of some mining commodities fell sharply in Q2. For instance, import of liquefied gases and petroleum products decreased by 20.8% and 40.3%, respectively. It was mainly attributed to the falling of both import price and import quantity, of which price indexes of liquefied gases and petroleum products went down by 8.05% and 31%, respectively in Q2.

69. Imports of capital goods were estimated at USD 22.3 billion in Q2 (Figure 30), up by 3.5%, accounting for 51.5% of total imports. This was the first increase of import of capital goods since Q2/2015, which may indicate a warm-up of domestic manufacturing sector.

70. For the first 6 months of 2016, imports amounted to USD 80.4 billion, decreasing by 0.8%. Notably, overall import price index fell by 7.77%, leading to an increase in import quantities by 7.6%.

Figure 31: Imports from major trading partners, Q2/2016 (%)



Source: General Department of Customs.

71. Import structure by trading partner varied only insignificantly in Q2. China continued to be the largest source of imports for Vietnam, with a share of 29.1% of total imports in Q2. Other important sources were South Korea (accounting for 18.4%), ASEAN (13.9%) and Japan (8.6%) (Figure 31).

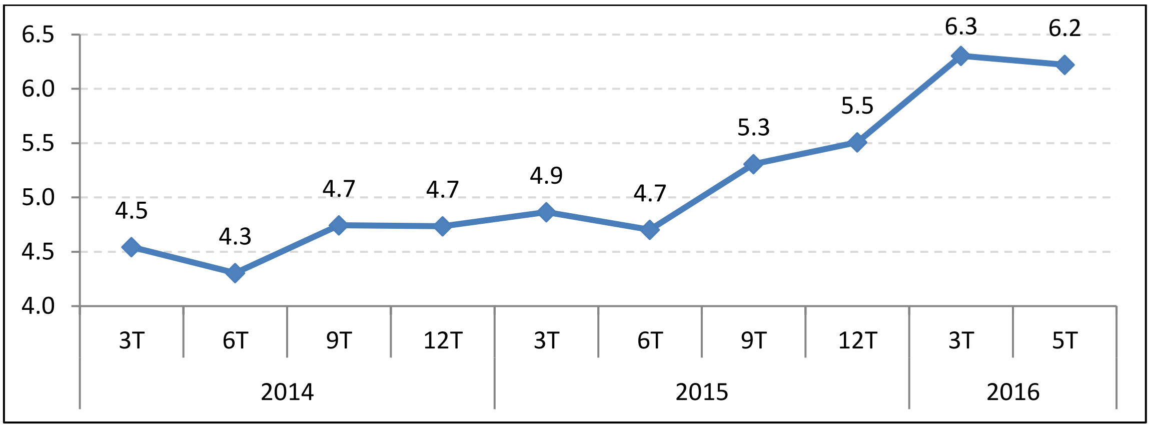
72. Among major trading partners, only South Korea had positive growth of exports to Vietnam in the first half of 2016. This issue remained out of attention of the media and researches. In fact, South Korea is becoming one of

[39] For instance, automobiles, some iron and steel products, v.v.

the most important trading partner of Vietnam, especially after Vietnam-Korean Free Trade Agreement (VKFTA).

a. The share of South Korea in Vietnam's exports was on upward trend since Q3/2015. Specifically, the share increased from 4.7% in the first 6 months of 2015 to 5.3% in the first 9 months of 2015 and to 6.2% in the first half of 2016 (Figure 32). As such, Vietnam's exports to South Korea increased faster than overall exports during Q3/2015-Q2/2016.

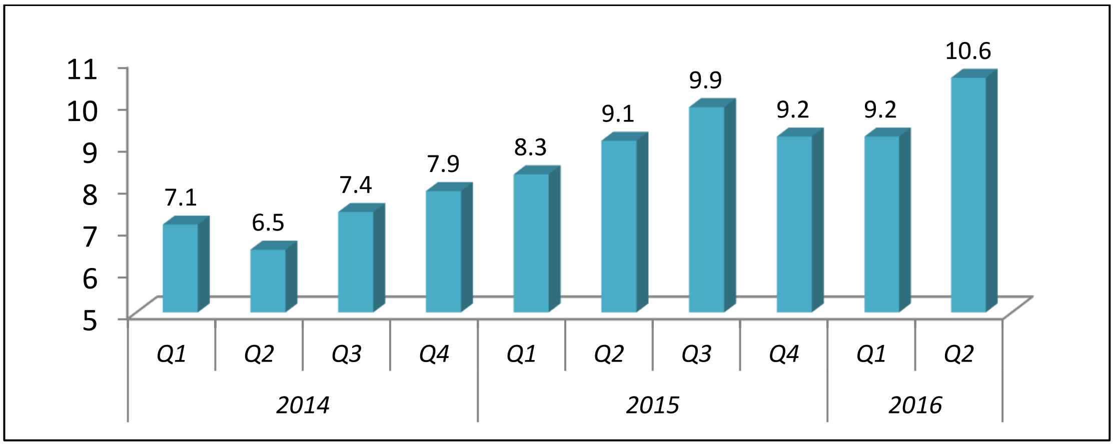
Figure 32: Share of South Korea in Vietnam's exports (%)



Source: Authors' calculation.

b. Export of some key commodities to South Korea increased significantly. Export value of computers, electronic equipment and spare parts reached USD 551.7 million in the first 6 months of 2016, rising by 79.9%. Exports of telephones and spare parts amounted to USD 1.3 billion in the first half of 2016, up by 217.4%.

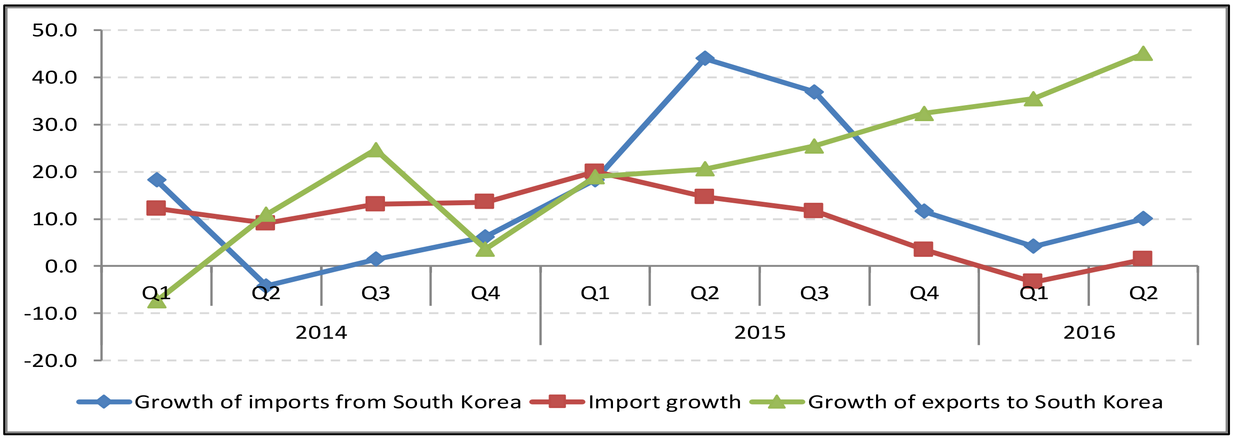
Figure 33: Vietnam-South Korea bilateral trade, 2014-2016 (billion USD)



Source: Authors' calculation.

c. Imports from South Korea increased faster than the overall import. In Q2/2016, imports from South Korea grew by 10.1% while the figure for overall imports was only 2.2%. Imports from South Korea were significantly larger (about 3 times) than exports. However, on YoY basis, export growth to South Korea clearly outpaced import growth from this market since Q3/2015. (Figure 34).

Figure 34: Exports to and imports from South Korea, Q1/2014-Q2/2016 (%)



Source: Authors' calculation

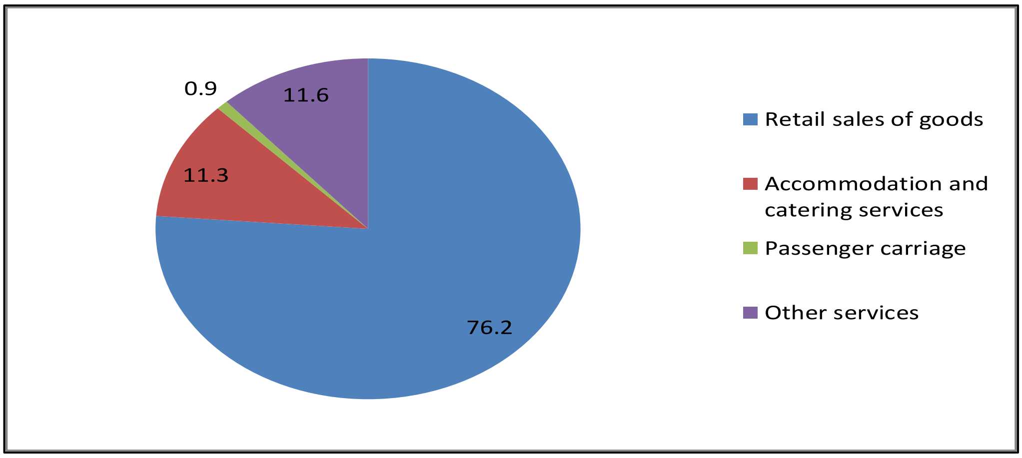
Note: YoY growth.

d. Bilateral trade with South Korea was estimated at USD 10.6 billion in Q2 (Figure 33), increasing by 17% or equivalent to 12.3% of Vietnam's total trade.

73. Trade surplus attained USD 334 million in Q2 (Figure 28), or 0.8% of total exports. For the first half of 2016, trade surplus reached USD 1.7 billion. Thus, the foreign exchange market was under little pressure from trading activities.

74. By economic sector, foreign-invested enterprises had a surplus of USD 5.5 billion while domestic sector experienced a deficit of USD 5.1 billion. Still, the linkages between foreign-invested and domestic firms were slowly improved. Therefore, the increase of foreign-invested enterprises' exports stimulated imports rather than improving domestic supply.[40] Thus, Vietnam only benefited to a modest extent from exports by the foreign-invested sector.

Figure 35: Retail sales of goods and services by activity, Q2/2016, (%)



Source: GSO.

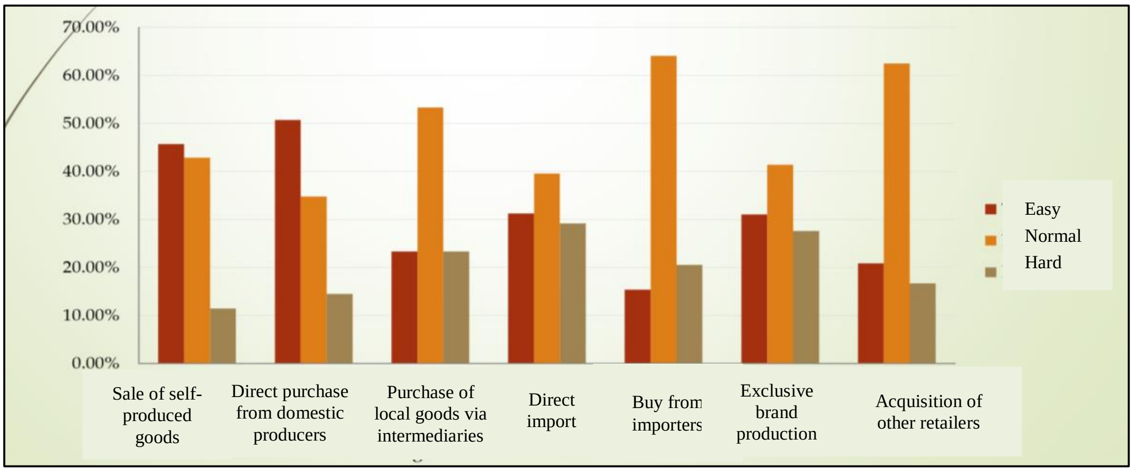
75. Total retail sales of goods and services amounted to VND 1,724 trillion in the first 6 months of 2016, rising by 9.5%. Excluding the price increase, the growth rate was 7.5%, lower than in the first half of 2015 (8.8%).

[40] Vo Tri Thanh, Nguyen Anh Duong and Bui Trinh (2015).

76. Retail sales of goods still accounted for the largest share (76.2%), attaining VND 1,314.3 trillion in the first 6 months, up by 9.8%. Accommodation, food and beverage services followed with the sales revenues of VND 195.5 trillion, making up a share of 11.3% and increasing by 7.4% (Figure 35).

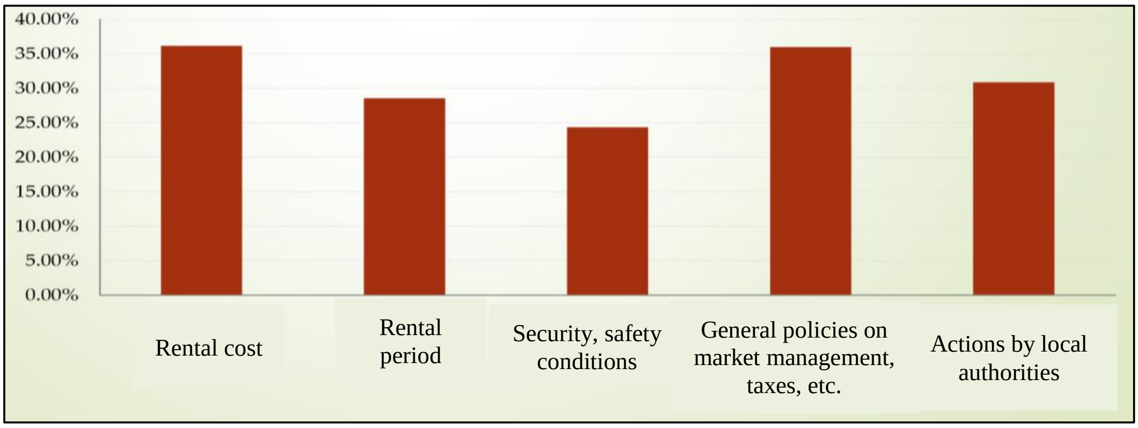
77. Vietnam's retail sector has been facing ample difficulties and challenges. From the production perspective, firms were only concerned about competitiveness in terms of product price and quality, without due attention to building distributional channels/linkages with domestic retail firms (Figure 36). Even retailers themselves had problems in terms of accessing to land and capital, and labor management, etc. The competition with foreign goods distributed through foreign retailers was no new; yet it became more urgent recently in the absence of policy incentives for boosting long-term development[41] and/or helping them connecting with other domestic firms.

Figure 36: Assess to supply for retail enterprises



Source: Dinh Thi My Loan (2016).

Figure 37: Inadequacies in access to land for retailers



Source: Dinh Thi My Loan (2016).

[41] Many domestic retailers had received favorable policies, but then had themselves acquired by foreign retailers.

1.6. Budget revenues and expenditures

78. Budget revenues attained VND 246.3 trillion in Q2/2016, up by 6.8% (QoQ) and 11.9% (YoY). For the first 6 months, budget revenues were estimated at VND 476.8 trillion, equal to 47.0% of the planned figures for 2016. Budget revenues to GDP ratio dropped from 27.1% in Q1 to 23.9% in Q2. The share of domestic revenues witnessed an upward trend, reaching 76.9% in Q2, considerably higher than the share of 70.9% in Q2/2015 and 74.2% in 2015. Meanwhile, both revenues from crude oil and exports and imports decreased. Contribution of revenues from crude oil went down to 4.6% in Q2. Revenues from trade were VND 44.4, decreasing by 6.9%.

79. In Q2/2016, budget expenditures amounted to VND 269.4 trillion, increasing by 2.4% (QoQ) and 0.6% (YoY). For the first 6 months of 2016, budget expenditures were equal to 41.8% of the planned figures for 2016. Budget expenditures to GDP ratio fell to 26.2% in Q2 from 30.9% in Q1. However, the share of expenditures for development investment went down to 13.2% in Q2, significantly lower than that in Q1 (17.8%) and those in 2013-2014 (of 25.1% and 20.7%, respectively). In contrast, the share of regular expenditures continued to increase. Debt repayment (including principal and interest) was estimated at VND 38 trillion in Q2, equal to 3.7% of GDP.

Table 6: Budget revenues and expenditures, 2013-2016

Unit: % GDP

	2013	*2014*	*2015*				*2016*	
			I	*II*	*III*	*IV*	*I*	*II*
Budget revenues	**23.1**	**21.9**	**27.9**	**22.7**	**22.1**	**23.3**	**27.1**	**23.9**
Domestic revenues	15.8	14.8	21.5	16.1	16.4	17.5	22.8	18.4
Crude oil revenues	3.4	2.5	2.1	2.0	1.5	1.2	1.0	1.1
Exports and imports revenues	3.6	4.4	4.4	4.6	4.0	4.0	3.2	4.3
Grants	0.3	0.2	0.0	0.0	0.2	0.6	0.0	0.1
Budget expenditures	**30.3**	**25.6**	**30.9**	**27.6**	**24.1**	**31.5**	**30.9**	**26.2**
Development investment	7.6	5.3	5.1	4.7	3.8	8.1	5.5	3.5
Budget deficit	**6.6**	**5.7**	**4.6**	**6.4**	**3.9**	**8.6**	**5.5**	**3.7**
Budget deficit (excluding principal repayment)	-	4.4	2.2	4.9	2.0	7.7	3.8	2.2

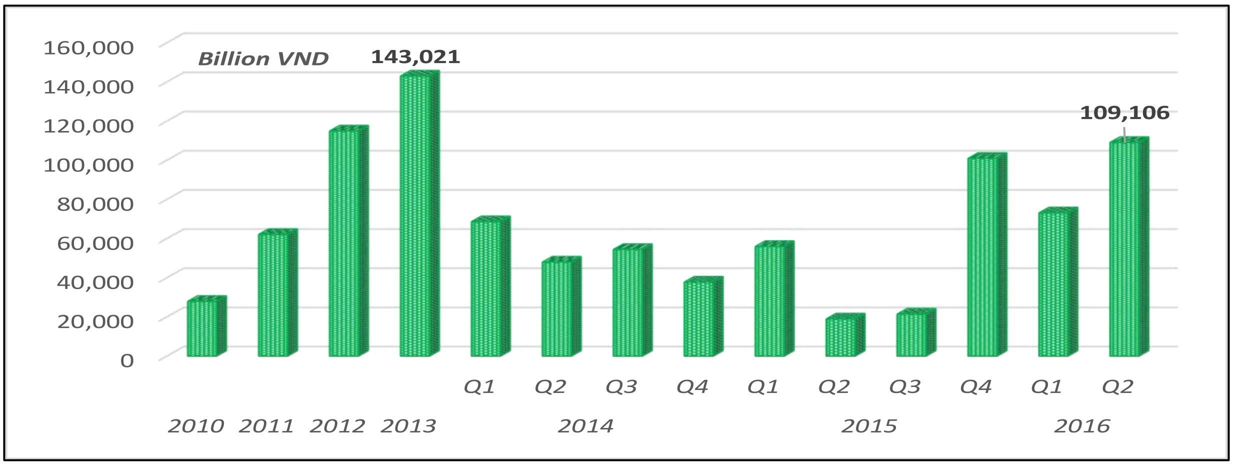
Source: Authors' calculation from MOF's statistics.

Note: 2013 figures were final account; 2014 figures were 2nd estimation; quarterly figures of 2015-2016 were estimates.

80. Government bond issuance continued to expand. Total value of government bonds issued in Q2 was VND 109.1 trillion, increasing by 49.1% (QoQ) and 5.8 times (YoY). In the first 6 months, total value of government bonds

amounted to VND 182.3 trillion (the figure for first half of 2015 was VND 197.4 trillion).

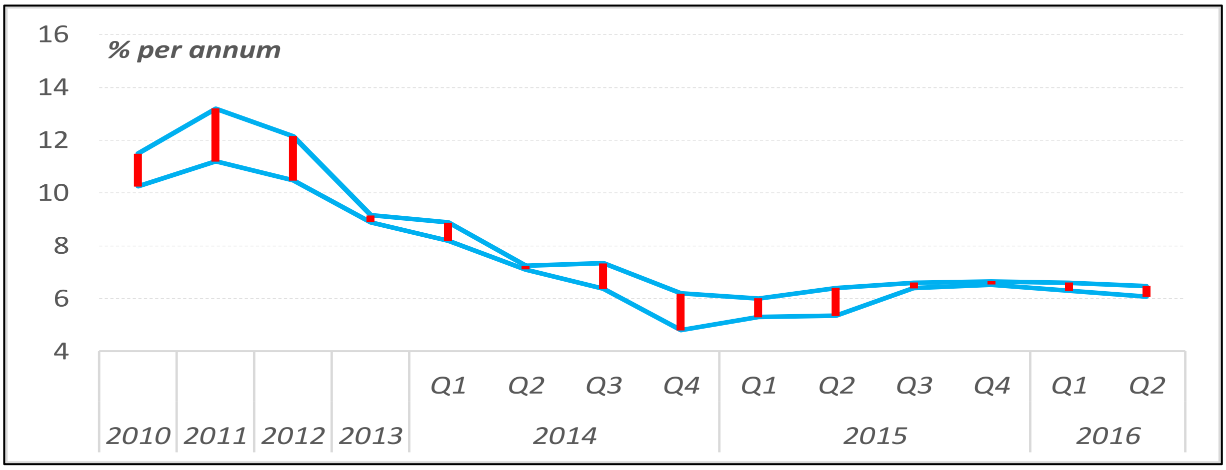
Figure 38: Government bond issuance, 2010-2016



Source: HNX.

81. Interest rate on Government bonds slightly decreased in the first 6 months of 2016. For 5-year terms to maturity, the rate was 6.07-6.48%/p.a. This range was lower than in Q1 (about 6.29%-6.6%/p.a). Similarly, the interest rate for successful bids of Government bonds for 3-year terms to maturity ranged from 5.25%-5.9%/p.a in the first 6 months; 10-year terms to maturity of 6.94%/p.a; 15-year terms to maturity of 7.65-8.10%/p.a; 20-year terms to maturity of 7.75%/p.a; 30-year terms to maturity of 8.00%/p.a. The lower interest rates for successful bids of Government bonds in Q2 was mainly attributed to: (i) coordination of monetary policy instruments in issuing government bonds, including the reschedule of targets for commercial banks after the amending the Circular No. 36/2014/TT-NHNN; (ii) low expectation of USD interest rate hike in the US; and (iii) increase in liquidity of commercial banks.

Figure 39: Interest rate on successful bids of Government bonds with 5-year terms to maturity



Source: HNX.

82. The collection ratio of budget revenues over the planned figures for the first 6 months of 2016 was lower than that in the first half of 2015. This low ratio

was, however, not because of the revenue-cutting measures. In fact, the pressure on increasing revenues to finance expenditures still persisted, especially given the limited sources for development investment. Making use of the previously issued government bonds is essential, but striking a balance between disbursement and efficiency of government bonds is no easy task. Accelerating the disbursement of government bonds – without matching control - would cause severe consequences to public debts in particular and macroeconomic management in general. More fundamentally, the issuance of government bonds should not be considered as an achievement, given inherent limitations[42] of this funding. To this extent, it is critical to discipline budget expenditures to create more space for public investment.[43]

2. *Macroeconomic outlook*

83. A forecast scenario is specified for Vietnam's economy in Q3. The scenario is based on some economic projections by international organizations as well as Vietnam's possible use of domestic policy instruments. GDP growth in partner countries is projected at 3.1%[44]. US inflation may reach 0.3%.[45] Export prices of agricultural products may decline by 1%.[46] The international crude oil price may fall by 5.5% compared to Q2.[47] For Vietnam, VND/USD exchange rate rises by 1%. Total liquidity goes up by 3%. Outstanding credit increases by 4%. Import prices may drop by 1%. The population is expected to increase by 0.26% and employment by 0.32%. The export volume of crude oil is assumed to be the same as the average volume of Q1 and Q2. REER remains unchanged (compared to Q2). On the balance of payment, (net) Government and private transfers will increase by 10% compared to Q2. Implemented FDI (including domestic and foreign capital) is expected to rise by 15% compared to Q2. Investment from State Budget and Government bonds are estimated at VND 60 trillion and VND 20 trillion, respectively.

Table 7: Projection of macroeconomic indicators

Unit: %

GDP growth rate (YoY)	6.14
Inflation (compared to Q2/2016)	1.31
Export growth (YoY)	6.8
Trade balance *(billion USD)*	-0.4

Source: CIEM's projection from macro-econometric model using quarterly data.

[42] Public investment was usually less efficient than private investment; crowding out effect of GBs to private sector's credit access, etc.

[43] Macroeconomic report for Q1/2016, CIEM.

[44] IMF forecast (7/2016), global GDP growth rate in 2016 is forecasted at 3.1%

[45] Inflation forecast for Q3/2016 (yoy) is 1.2%. Source: http://www.tradingeconomics.com/united-states/forecast. [Accessed on 21/07/2016]

[46] EIU forecast (20/7/2016)

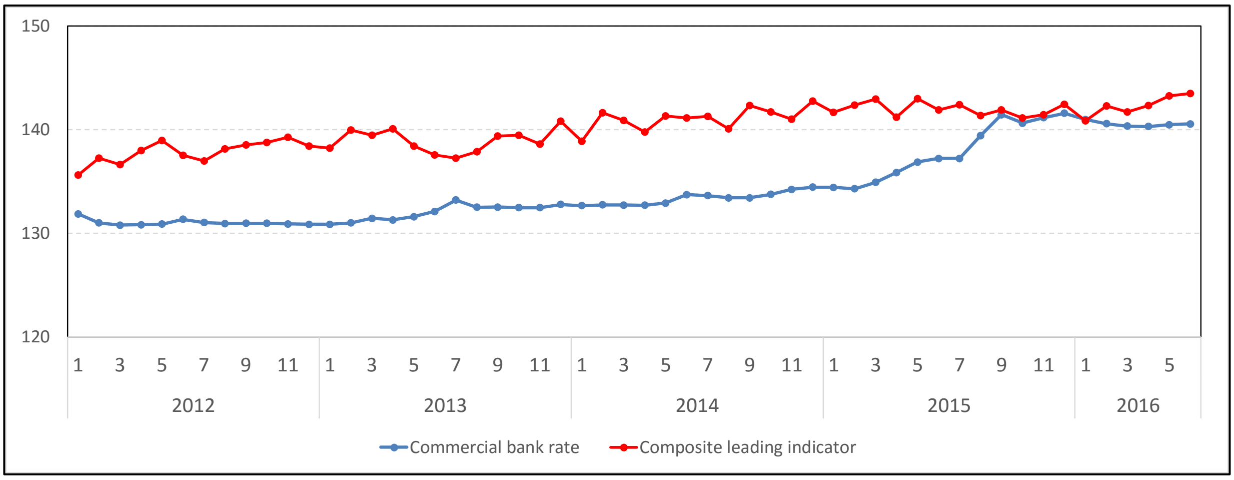
[47] EIU forecast (20/7/2016)

84. YoY GDP growth rate in Q3 is projected at 6.14% (Table 7). Export growth in Q3 (YoY) may reach 6.8%. Trade deficit is projected at USD 0.4 billion. CPI may increase by 1.31% in Q3.

85. CIEM's leading indicators of exchange rate[48] shows no substantial change (above 3%) at the most recent time, implying that the exchange rate of commercial banks will be stable in the last 6 months of 2016 (with a probability of 94.73%).

86. Macroeconomic conditions in Q3 are subject to several factors. *First*, Brexit may lead to follow-up events and/or changes. The emerging uncertainties – such as pace, complementary policies of the UK and EU, responses of financial market and major economies – could significantly affect Vietnam's trade and investment. A possible risk could be the depreciation or the devaluation of major currencies against USD. *Second*, FED may decide to adjust USD interest rate; the probability of interest rate reduction is no longer excluded. *Third*, there has been no sign that some large FTAs such as TPP, EVFTA will be ratified in Q3. As a consequence, the adjustment of regulatory documents in preparation for those FTAs could be delayed (perhaps to Q4).

Figure 40: Leading indicator of exchange rate



Source: Authors' calculation.

[48] Monthly calculation, based on component indicators of inflation, interest rate and trade deficit.

III. SELECTED ECONOMIC ISSUES

1. *Addressing challenges from ASEAN Economic Community integration track*

87. The ASEAN Economic Community (AEC) - officially established at the end of 2015 - has broadened economic opportunities for member states to get access to a single market with total population of 622 million, total GDP of nearly USD 2,600 billion and total trade value of USD 2,500 billion (7% of total world trade). ASEAN presents the top destination for foreign investors, attracting about 11% of total global FDI in 2014[49]. AEC is expected to boost intra-regional trade with the formation of a single market, aiming to create a single production base. In fact, ASEAN members have been collaborating with one another to promote liberalization in many areas, such as tariff reductions, services liberalization, investment cooperation, trade facilitation, and skilled labor mobility, etc.

88. For Vietnam, ASEAN is one of the most important trading partners, creating an important momentum for the economy to maintain growth rate and export for many years. ASEAN member states currently rank 3rd among sources of imports for Vietnam (after China and South Korea) and are the fourth largest export market of Vietnam (after the US, EU and China).[50] ASEAN member states also provide a big source of FDI for Vietnam. By November 2015, ASEAN countries had invested more than USD 56.8 billion in Vietnam. Notably, ASEAN is the only organization signing Free Trade Agreements (FTAs) with all large and medium-sized economies in the Asia - Pacific region, including China, India, Japan, Korea, Australia, and New Zealand. Furthermore, the relatively high commitment to liberalize trade in goods under AEC provides a huge advantage for movement of goods within ASEAN, while enabling enterprises to lower production costs, improve product quality, thus enhancing product competitiveness.

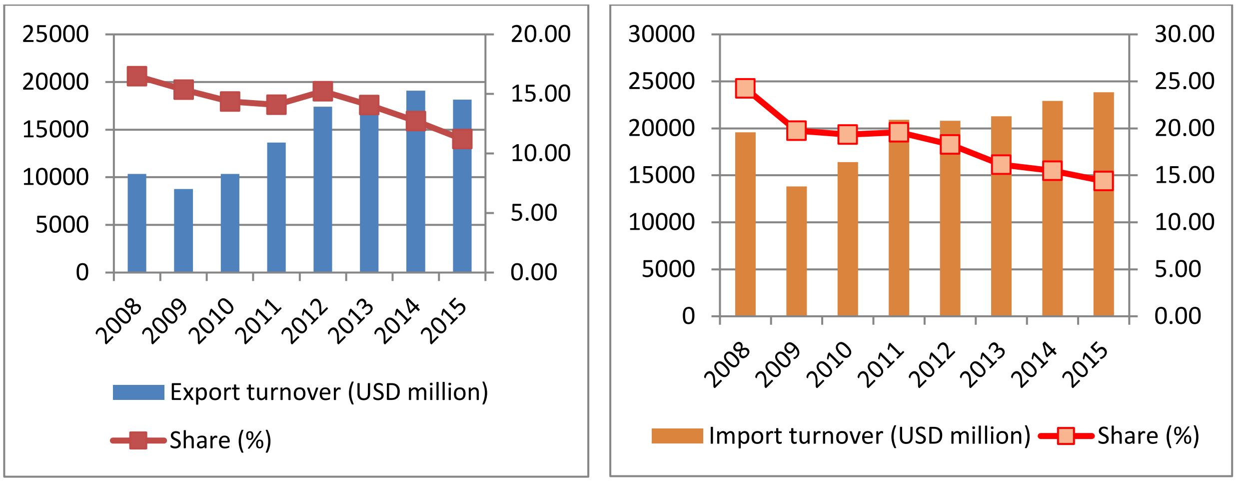
89. Joining AEC can present enormous opportunities for Vietnam. Specifically, Vietnam has the opportunity to expand market access for goods and services, to attract FDI, to accelerate the process of restructuring economic institutions, thereby positioning the country in a more advantageous position in the regional and global production chains and distribution network. Skilled labor will be freer to move and easier to find suitable jobs in the region. AEC can estimatedly help Vietnam's GDP to increase by 14.5% and to create more 10.5% of jobs by 2025. The share of employment in industry sector will increase to 23.5% by 2025. In particular, expansion of commercial activities, goods and services transport will help to create more jobs, even contributing up to 41.3% of total jobs newly created in the economy.

90. Vietnam’s trade with ASEAN has decreased quite rapidly in terms of share, in spite of increasing in absolute terms. In 2015, exports and imports of Vietnam

[49] Data from the ASEAN Secretariat and UNCTAD.
[50] See Trade section in Chapter II.

with ASEAN were USD 18.16 billion and 23.83 billion, respectively. ASEAN's share in Vietnam's exports fell from 18.30% in 2012 to 14.39% in 2015, and the share in imports fell from 15.22% to 11.20% in the same period (Figure 41). Accordingly, Vietnam trade, especially exports, seems to divert further to large non-ASEAN trade partners such as the US, EU, China and South Korea.

Figure 41: Trade developments between Vietnam and ASEAN



Source: GSO and General Department of Customs.

Note: Import and export values are reflected in the left axis; the shares are on the right axis.

91. The structure of exports to ASEAN has gradually shifted away from raw products (accounting for over 50% of total exports prior to 2010) to consumer products with a higher processing content such as processed agricultural products, cosmetics and industrial products. In particular, the share of machinery/electrical equipment (HS84-85) in total exports increased sharply from 14.67% in 2010 to 30.53% in 2013 and reached 26.86% in 2014[51].

92. However, AEC integration track has revealed many challenges for Vietnam. *First*, ASEAN members are quite different in terms of development level and they compete against one another in exports and attraction of FDI, especially with non-ASEAN trading partners such as China, EU, US, Japan, and Korea. The intra-regional integration commitments of ASEAN are somewhat short of incentives and less meaningful. The reliance on the large non-ASEAN economies also makes ASEAN more vulnerable to external shocks. Meanwhile, the common mechanisms to jointly mitigate impacts of those shocks are still limited.

93. *Second*, managerial agencies and enterprises lack full understanding of or attention to competitive pressures in light of AEC integration. Too much attention is paid to TPP and FTA with the EU while these agreements are still pending for ratification; the AEC, meanwhile, has been implemented with more material and real impacts.

94. The mix of competition inside and outside ASEAN is quite strong and complex, which is reflected in trade indicators between Vietnam and ASEAN

[51] Calculated from the database of UN COMTRADE.

and other key trading partners (Table 8). The Export Similarity Index (XS) shows that Vietnam and ASEAN have quite similar export structure. The level of trade complementarity between Vietnam and ASEAN is even higher, suggesting that ASEAN's goods fit well with Vietnam's consumer demand. Meanwhile, bilateral trade flow between Vietnam and ASEAN is larger than expected.

Table 8: Trade potentials of AEC and key trading partners

	Export Similarity (XS)	***Trade Complementarity (TC)***	***Trade Intensity (TI)***
ASEAN	63.44	55.84	1.92
EU-28	66.76	51.04	0.59
China	66.83	52.33	0.96
USA	66.83	53.88	1.49
Japan	62.69	52.15	2.27
India	37.06	37.14	0.69

Source: Authors' calculation from UN COMTRADE database.

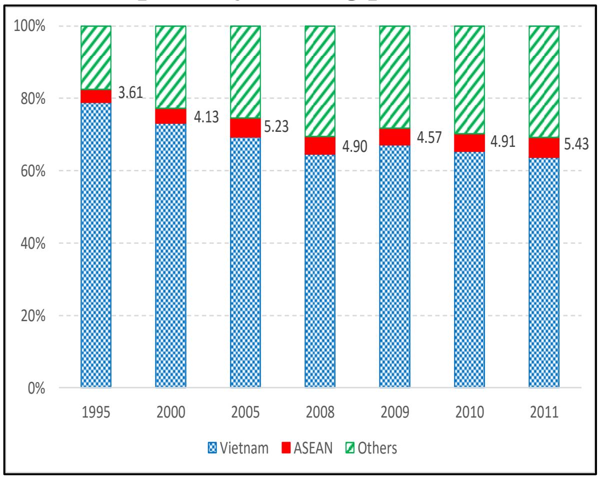
95. *Third*, strengthening competitiveness of Vietnam's businesses is no easy task. The weak competitiveness of Vietnam's businesses is reflected in various aspects, including: (i) small size of capital and outdated equipment; (ii) limited skill of labor, especially in the majority of SMEs; (iii) limited business strategies where many companies focused almost solely on short-term benefits. For ASEAN market in particular, the limited competitiveness of Vietnam's enterprises is reflected in the followings:

a. Vietnamese enterprises only care about competitiveness in terms of price and quality of goods. Meanwhile, the participation in the regional value chain requires enhancing the competitiveness in at least three more aspects, including: (i) large-scale production; (ii) just-in-time delivery of goods; and (iii) getting access to appropriate distribution channels. To meet large orders is not easy, particularly when businesses are mainly small and medium while credit provision is yet to target production/manufacturing. Furthermore, little attention to the just-in-time delivery to customers will lead to increased costs of storage (for too early delivery) or incurred loss with other partners (for too late delivery). Finally, domestic enterprises do not pay due attention to strengthening their distribution channels, especially modern channels, which constrains the sale of products as well as the operation of the domestic retail sector. This concern becomes increasingly visible when some Thai investors have approached and increased their ownership of Vietnam's retail establishments. In fact, should these investors prioritize distribution of imported products from Thailand (to Vietnamese products), policy intervention is unlikely.

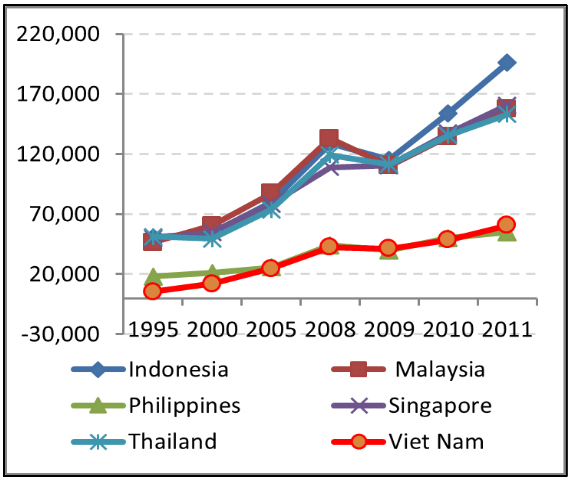
b. Vietnamese enterprises, including those directly engaged in commercial activities and/or use of imported inputs, are still lack of awareness in utilizing preferential treatment under ASEAN framework. The most difficult one is to meet the rules of origin (RoO) although ASEAN allows for application of cumulative RoO. Specifically, Vietnamese enterprises are concerned only about preferential tariffs if they are sufficiently smaller than MFN tariffs. Meanwhile, few businesses are interested in requiring certificates of origin (CO) for imported goods (even when the preferential tariffs in ASEAN are the same as MFN ones). Therefore, when exporting to other ASEAN countries, few enterprises meet the cumulative RoO and are not entitled to preferential tariffs. This is one of the reasons why ASEAN's content in Vietnam's exports is slowly improved (Figure 42a). In turn, this issue will also limit the competitiveness of Vietnamese enterprises when exporting to the ASEAN countries.

Figure 42: Domestic value added content of exports

(a) Value added content in Vietnam's exports by trading partners



(b) Domestic value added content in exports of selected ASEAN members



Source: Authors' calculation from OECD database.

c. The aforementioned weaknesses are even more alarming as Vietnam enterprises have inadequate business strategies in alignment with the ASEAN market. For example, enterprises pay no attention or are not resourced for identifying the network of suppliers in ASEAN countries so as to have additional regional value content and meet the cumulative RoO upon exporting to other ASEAN members. Meanwhile, the EIU (2014) shows that many multinational corporations already amended their business strategies at the regional level ahead of AEC (such as downsizing their representative offices and affiliates in ASEAN, focusing on supply to all destinations in ASEAN, and focusing on ASEAN customers rather than on each ASEAN member state, etc.).

96. Even in terms of price and quality, Vietnam's enterprises lack competitiveness compared to those in other countries such as Indonesia, Malaysia or Thailand. Therefore, imports from ASEAN have increased quite rapidly in recent years (Figure 41). As reported by the General Department of Customs, among ASEAN market, Vietnam experienced insignificant trade surplus with Cambodia, Philippines, Indonesia and Myanmar, while suffering huge trade

deficits with Thailand (USD 3.45 billion). Notably, Thai products, especially consumption goods, cosmetics, interior decorations and vegetables, were available in almost distribution channels of Vietnam and outperformed local products in terms of competitiveness.

97. The fourth challenge is how to enhance the participation of Vietnam enterprises in the regional supply chain. According to a VCCI survey in 2015, only 36% of Vietnamese enterprises were engaged in the production network, including direct and indirect exports, while the ratio in Malaysia and Thailand is 60%. Only 21% of Vietnamese SMEs participated in the global value chain as compared to 30% in Thailand and 46% of Malaysia. Most new businesses only participated in the assembling, processing or supply of spare parts, but still possess inadequate capacity or initiatives to engage in the manufacturing of main products/stages of production.

98. Over the past years, the spillover effects of FDI remained limited. Domestic enterprises hardly have linkages with FDI firms. There is practically a mismatch: domestic enterprises want to secure contracts with FDI firms so as to confidently invest in production technology, while FDI firms normally have their own supply networks and often want domestic enterprises to firstly offer their products and to prove their supply capacity. Meanwhile, the management authorities have few efforts to introduce and connect domestic suppliers with FDI firms.

99. On average, in 1995-2011, the domestic value added (DVA) accounted for 68% of exports. However, the growth rate of Vietnam's DVA was slower than other ASEAN member states and the gap seemed to be widening over time (Figure 42b). Accordingly, the DVA of Vietnam’s exports remained low and show no significant changes. Except for the mining and quarrying products, and raw and processed products of AFF sector, other export products showed little improvement in the share of DVA. Most of the manufacturing exports just reached 33-35% of DVA over total exports which were much lower than Indonesia, Malaysia and Thailand.

100. *Fifth*, it is not easy to take advantages of abundant labors and natural resources while moving up the value chain for higher value-added industries in ASEAN. Vietnam is still short of skilled labors and qualification of foreign languages (English), so the realization of opportunities for Vietnamese labors to find jobs in other ASEAN countries is challenged. To another extent, even retaining skilled labors to work in Vietnam has become more and more difficult due to the risk of a brain drain; these skilled workers may just move to work in ASEAN-6 countries for better income and working conditions. Should Vietnam fail to handle this problem, its labor productivity may lag further behind other regional countries.

101. In the short term, Vietnam can still enjoy its static cheap-labour-based comparative advantages in a wide range of labor-intensive industries. Yet such advantages are deteriorating. Therefore, in the medium and long-term, the country has to work further to acquire dynamic comparative advantage in other

industries, particularly those with high value-added content. This, however, depends crucially upon the improvement of national institutions (public governance and management of production factor markets) in general and developing human resources in particular.

102. *Finally,* Vietnam may face challenges in harmonizing the commitments and integration tracks for maximizing benefits and opportunities. AEC, TPP, Vietnam-EU FTA have often been viewed separately with a lack of cohesion. The excessive attention of the media to new generation FTAs seems to obscure the importance of regional integration in general and of AEC in particular. This lead to the underutilization of opportunities from ASEAN, while pressures materialize from increasing imports and competition from ASEAN’s goods and enterprises. In another aspect, current policies fail to incentivize Vietnamese enterprises to realize opportunities from the “low standard” FTA ("low-hanging fruits") like ASEAN FTA and AEC, for accumulating experience and resources to meet higher standard FTAs (such as TPP and Vietnam-EU FTA, which may take effect by 2018 at the soonest).

Some policy implications

103. *First*, to improve the legal environment and framework to promote trade facilitation and enhance investment in ASEAN, in line with the common priorities and mindset towards the importance of this partnership. There is a need to review, supplement and develop appropriate policies and legislation to improve the regulatory framework in Vietnam on the basis of harmonization with regional commitments on AEC implementation; to focus on research, forecasting, and formulation of development roadmaps, strategic plans for key sectors and commodities, thereby providing orientation and consultation for enterprises to maximize the advantages of geographical location, human resources, etc.

a. To link administrative reforms in trade, services and investment with the implementation of commitments of international economic integration in general and of AEC integration in particular. One of the focuses is to implement the national single window (to integrate all import and export procedures into a single focal point and to electronize). In the future, the ASEAN exporters or importers just need to use the electronic portal of the General Department of Customs to complete all online procedures related to declaration, licensing, and customs clearance.

b. Increasing competition between domestic and imported goods - in some sectors - can also be a necessary "pressure" for Vietnam’s determination in formulating a focused industrial policy. The scattered and fragmented development would be ineffective given currently limited resources.

104. *Second,* to support the business community, especially SMEs, to get access to necessary resources, including: (i) formal credit; (ii) skilled labor; (iii) science and technology; and (iv) management skills, especially risk management in the context of deeper integration.

105. *Third,* to strengthen the competitiveness of enterprises with focus on:

a. Leveraging the intermediary role of state agencies in promote linkages between domestic enterprises and FDI firms.

b. Supporting and guiding enterprises to renovate their governance, to proactively approach information, to build strategic and long-term business visions, and align thinking and business methods in chains and groups. Encouraging businesses, especially in industrial associations and services sector, to learn from one another about business strategy, and to jointly participate in the value chains, enhancing strengths thanks to economies of scale and improved utilization of comparative advantage.

c. Supporting enterprises to learn and use hedging instruments such as forward market, derivatives, insurance, etc.

d. Sharing information, providing warnings to businesses to realize and meet requirements related to the standards, technical barriers, especially in developed markets.

e. Incentivizing and supporting capacity building for enterprises to gradually shift from price competition to non-price competition associated with improved standards, transaction models, and distribution channels, etc.

106. AEC integration means more than the liberalization of trade, services and investment under new generation FTAs, but also aims towards strengthening the central role of Southeast Asia as the hub of the global production network and value chain. Therefore, participating in and realizing opportunities from ASEAN needs matching attention. Also, management agencies can only facilitate and support capacity building for enterprises to effectively compete in the ASEAN arena, but they cannot compete "on behalf of" businesses. Enterprises need to be more proactive, not only in accessing to integration information in general and ASEAN in particular but also in renewing business strategies and risk management.

2. *Difficulties and challenges in establishing specialized agency as representative of state owner*

Good administration and effective use of huge public assets in the economy is both an urgent requirement and important driving force for sustaining economic growth and improving national welfare.

107. The State, specifically the governments at central and local level, acts as an enormous investor, holding the biggest value of capital and assets of any investor in a given country. Of all 500 globally largest companies, according to Fortune Global (2014), SOEs accounted for 22.8% of total number of enterprises, 30% of employees, 24.1% of revenue, 23.0% of assets and 19.9% of profit. Total revenues of SOEs in the list of 2,000 largest companies of Forbes Global reached USD 3.6 trillion, equal to 6% of global GDP. In OECD countries (2012), there was a total of 2,111 SOEs, with total assets of USD 2,218.1 billion and creating jobs for more than 6 million workers. Many

countries registered SOEs' asset value of over USD 100 billion such as Norway (243.7 billion), Korean (200.9 billion), Japan (339.3 billion), Italy (226.1 billion), France (111.4 billion), etc. Also according to OECD (2011), SOEs contributed approximately 15% to GDP in the reported member states on average. Some countries even registered over 20% of SOEs' contribution to GDP such as Czech Republic, Finland, Israel, Poland, and Norway.

To improve the efficiency of using these particularly important resources, one of the fundamental solutions is to have a professional and specialized apparatus responsible for managing and supervising state assets in a centralized manner, including the state capital invested in enterprises.

108. This measure is drawn from the worldwide reforms of state asset management and SOEs governance in the past decades with proven and verified benefits, including:

a. First of all, specialization and professionalism of the apparatus for managing and supervising state assets in enterprises leads to the separation of State's ownership function from policy formulating, regulatory or supervisory functions; thus breaking cronyism between competent authorities with the power of resource allocation and enterprises as users of resources, minimizing policy advantage for and putting SOEs in equal and fair competition in the market, creating a level-playing business environment for all types of enterprises. This is particularly important for the countries in transition toward a full, modern and integrated market economy.

b. The specific measure is to centralize SOEs to an institution or economic organization specializing in management and supervision functions. This specialized entity may either be independent or within the organizational structure of a government agency **(**Table 9), but it is important that the agency will not exercise state administrative management functions or have any in regulating the market, and will be separated from management of ministries.

c. The centralization of State commercial assets to a single entity for unified management and supervision enables the Government (ownership representative) to build a consistent information database, which would be easy to identify: (i) how much assets are currently under state governance; ii) specific types of assets, iii) book value and market value of all and specific assets; (iv) location of assets; and (v) profitable assets, inefficiently used assets which reduced national wealth, and the opportunities and capabilities for improving efficiency of assets, etc.

d. The aforementioned information system will enable not only the government, but also the public and market to oversee and assess the effectiveness and efficiency of using pubic capital and assets.

e. The specialization and professionalism of state-ownership functions, investment functions, management and utilization of state-owned capital and assets also lay a better foundation for the development of core competencies, good management tools, effective organization and human resources in a stable and long-term basis; minimize administrative intervention and political interference in management and utilization of state assets, distorting strategic and long-term goals of state investments.

Table 9: Models of Centralized Ownership Arrangements

Country	Name of entity	Location of entity
1. Ownership under government		
1.1. Ownership ministries		
Indonesia	Ministry of State Enterprises	Ministry of State Enterprises
1.2. Ownership departments in a ministry		
Finland	Ownership Steering Department	Prime Minister's Office
France	Agence des Participations de l'Etat	Ministry of Economy and Finance
Norway	Ownership Department	Ministry of Trade and Industry
Poland	Department of Ownership Supervision	Ministry of Treasury
South Africa	Department of Public Enterprises	Ministry of Treasury
United Kingdom	Shareholder Executive	Department for Business
1.3. Independent ownership agency		
China	State-Owned Assets Supervision and Administration Commission	State Council
2. Company-type structure		
Bhutan	Druk Holding and Investments	Ministry of Finance
Hungary	State Holding Company	State Holding National Board
Malaysia	Khazanah Nasional	Ministry of Finance
Peru	Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado Holding company	Ministry of Finance
Singapore	Temasek Holdings	Ministry of Finance

Source: World Bank (2014).

f. Finally, the concentration of state resources, capital and assets is to focus on executing critical and strategic tasks aimed at gaining the highest added value for the society over the long- term basis, to which the private sector does not do or cannot do instead of fragmented resources in various industries and businesses.

In Vietnam, the value of state capital and assets invested in business is enormous. The centralized management and supervision will: (i) help improve the efficiency of utilizing these important capital and assets, thereby producing positive impacts on growth, efficiency and overall competitiveness of the economy; (ii) be expected as an effective tool for the State to provide orientation to socio-economic development.

109. According to a Report of the Government at the National Assembly Meeting at the end of 2015, total assets of 781 SOEs alone amounted to VND 3,105 trillion, and total state equity of VND reached 1,233 trillion. According to GSO figures in 2014, the total assets of SOEs and enterprises holding more than 50% state-ownership attained VND 5,408.4 trillion. By a simple estimation, if the efficiency increases by an additional one percentage point, the current state capital and assets will generate an additional value of approximately USD 2.5 billion and contribute significantly to macroeconomic balances.

110. The efficiency of utilizing state capital and assets invested in production and business is low as compared to private funds and even much lower than foreign invested capital. According to GSO (2014), SOEs, including enterprises with dominant State shares, accounted for 32% of the business/operational capital, 39% of fixed assets and long-term investments, but only generated 24% of total revenues, less than 20% of industrial production output, and a small share in domestic trade, AFF, etc.

111. The volume of state capital and assets are being fragmented across almost all sectors and industries in the economy, both in terms of where they are used and which organizations are responsible for their management and supervision. The goal of centralizing resources for the state economic sector to properly play its roles and functions in the reform process has not been realized.

112. The current mechanism has revealed too many defects and proved to be inconsistent, inefficient and ineffective in exercising state-ownership rights, management and utilization of state capital and assets in many aspects, including: (i) the existence of too many focal points, lacking clear and consistent targets; (ii) too many duplicated management units, resulted in a shortage of comprehensive and unified database of enterprise and its asset components, and total assets of the State, thereby failing to get accurate and on-time assessment of efficiency of using state capital and assets; (iii) too many focal points and lack of effective coordination mechanisms; (iv) too many focal points, leading to no specific entity being accountable to the Government, the National Assembly and the people, irresponsibility in management and use of state assets and abusing power for personal and group interests; (v) ministries have executed state ownership rights with administrative thinking, administrative tools and processes, which are completely inconsistent with requirements of investment, management and use of state assets; and (vi) the current dual roles of state administrative management and of state ownership representative of ministries which has created conflicts of interest among functions of ministries, and unequal and unfair competition in the market, thereby causing negative impacts on the development of other businesses.

113. In summary, the current scattered and fragmented management arrangement of SOEs under various ministries has undermined the effectiveness and even disabled the people’s ownership rights via the State as representative, with regard to state capital and assets invested in enterprises.

114. Given the above-mentioned situation and in its efforts to internalize international practices in public assets and SOEs governance, Vietnam had the initiative to centralize state capital invested in businesses under the management and supervision of specialized and professional entities. The 12th Party Congress Resolution (2016) further affirms the viewpoints to: "Separate functions of ownership from state administrative management functions and business administration functions of SOEs; promptly eliminate state-ownership functions of ministries and people's committees of state capital and assets. Establish a specialized agency to act as state-ownership representative of SOEs".

115. The afore-mentioned initiative has been in place for years. However, the institutionalization of policy in written documentation only started since the beginning of 2016 when the Government assigned the Ministry of Planning and Investment to develop a Decree on the establishment of a specialized agency acting as state-ownership representative.

Vietnam aims to establish a specialized agency accompanied by the transfer of ownership rights from state management agencies. Line ministries have raised many obstacles and shared different views on the roadmap, steps and ways of execution, and design of specific regulations. Lacking adequate measures to fully address these obstacles would present big challenges and threats to the success of the model of a specialized entity after its establishment.

116. As compared to previous years, recent discussions have shown high consensus about the necessity of establishment of a specialized entity, at least in formality because this is required to be done in implementing Resolution of the 12th Party Congress.

117. However, there are still views (mainly from line ministries and a number of economic groups and large corporations), which on the one hand agree with the need for a specialized entity, and on the other hand raise concerns about the transfer of management of SOEs and state capital to the new entity for various reasons, namely: (i) the transfer of state economic groups and large corporations to the new agency may create an extravagate power, which may lead to the potential abuse of power; (ii) the establishment of a specialized entity and transfer of SOEs to the agency may affect the process of restructuring and equitization of SOEs under line ministries; instead, there need not to transfer SOEs to specialized entity in the context of integration and development of a full market economy, as the number of SOEs will be declined under equitization process; (iii) the establishment of a specialized entity would increase the personnel, which is against the orientation of personnel downsizing of the State; (iv) skepticism about the capacity of SOEs management and supervision of the specialized agency, with the view that many ministries joining in SOEs management and supervision may still be better than just one specialized agency as proposed.

118. The afore-mentioned concerns imply the desire to maintain the current decentralized mechanism of SOEs management and state capital invested in production and business in dozens of focal agencies.

119. For whatever motivation, these concerns also create requirements of legislation in designing a model of effective specialized entity. Such an entity must be capable of overcoming limitations and shortcomings of the current decentralized mechanism of state ownership rights and, at the same time, addressing inadequacy of awareness and actions on the institutionalization of this important policy. Key requirements include:

<u>(i) The design of the specialized entity acting as representative of State owner must derived from its positions, roles and functions in the context of Vietnam:</u>

120. The establishment of the specialized entity resulted from separating state administrative management function from state ownership function carried out by managerial agencies, aiming at minimizing the issuance of policies distorting the market; creating a healthy competitive environment among enterprises; and forcing state-ownership enterprises to operate under the full market mechanism, thus achieving the ultimate goal of increasing opportunities for improved efficiency of state capital and assets invested in enterprises' production and business.

121. The specialized entity must not be a state administrative agency and have no state management function for different types of enterprises. Instead, the entity has functions of investing, allocating, supervising, and utilizing state capital and assets in accordance with government objectives and towards maximizing the value of state capital and assets.

122. Status or position of the specialized entity needs to be carefully considered. In most countries, the specialized entity can assume a corporate structure, an independent body or an agency within the organizational structure of synthesis ministries such as Ministry of Finance, Ministry of Economy, Office of the Government (Table 9), provided that it is separated from the management of line ministries and fully accountable to the Parliament, the Government, the public and the market.

123. In Vietnam, currently, the legal and political position of the specialized entity will have significant influence on the goals of establishing such agency. In the past 10 years, the State Capital Investment Corporation (SCIC) was a good model in compliance with international practices on the professional and specialized management apparatus of state capital and assets. However, the "low" status of SCIC makes it difficult to "manage" state economic groups and large state corporations. In addition, a specialized entity under the organizational structure of a ministry will be difficult to meet the requirement of "independence" and being levelled with line ministries in exercising the rights of state ownership representative.

124. The specialized entity, in the coming time, should be at ministerial-level or governmental agency. Of which, the form of a governmental agency is

preferable for two reasons. *First*, the governmental agency has no function of issuing legal documents, and no authority to inspect and impose administrative sanctions against enterprises of other economic sectors. This option both meets the requirement of being independence from the state administrative management apparatus and avoids the risk of promulgating biased policies distorting competition or creating unequal treatment in the market. *Second*, the establishment of a governmental agency is under the jurisdiction of the Government, which is simpler in terms of legal procedures than the establishment of a ministerial-level agency.

125. The specialized agency in the form of a governmental agency will have the following mandates:

   a. Mandates related to management and supervision of SOEs and the share of state capital in assigned enterprises. In fulfilling these mandates, the specialized agency has full rights of state-ownership of SOEs, shareholder of joint-stock companies, and members of limited liability companies with two or more members regulated by laws, unless the issues are under authority of the Government, the Prime Minister.

   b. Advisory tasks to assist the Government in consistently implementing function of state-ownership representative over nationwide state capital and assets invested in production and business. Of which, the most important task is to develop and submit policies related to state-ownership for approval by the Government and the Prime Minister, including objectives and indicators for annual and 5-year assessment of state capital in the whole economy, in each sector and in each enterprise; measures for realizing objectives and modalities of implementation, including equitization, state capital divestment, restructuring of investment portfolio and responsible actors; ways of tracking, monitoring and evaluation, reporting and other relevant contents.

   c. Tasks that a governmental agency must comply as regulated by law, including strategies, programs, plans; implementation of public services; international cooperation; administrative reforms; information and reporting regime; and organizational structure and financial and asset management of the agency.

   d. Given the above-mentioned tasks, clear and enforceable regulations must be in place on the responsibility of the specialized agency in implementing the approved SOE restructuring plan. At the same time, one of the most important tasks for the agency is to maximize the value of state capital invested in enterprises, regardless of SOEs or equitized enterprises. Ultimately, the nature of equitization is to restructure State asset portfolio to make it grow, rather than to lose in absolute term.

<u>(ii) It is necessary to design a strict, appropriate and efficient supervision mechanism of organization and operation of specialized agency to avoid the potential abuse of power:</u>

126. Contents of supervision must be adequate, including internal and external supervision; *ex ante*, concurrent and *ex post* supervision to all decisions of the specialized agency in executing the tasks related to enterprises under authority. Together with supervision, an effective mechanism is required for evaluating the legitimacy, rationality and effectiveness of the implementation of rights, obligations and responsibilities of the specialized agency; results and efficiency of investment, management and use of state capital in the whole economy. The Government assumes overarching supervision of the specialized agency with the participation of various stakeholders.

127. To effectively supervise and evaluate the specialized agency, there is a need to compile the list of enterprise as well as their portfolio and assets, to identify their current status and corresponding value; to determine missions, goals, tasks and basic indicators (financial and non-financial indicators) for the assessment of operation of the specialized agency; identify an internal supervision body to report regularly and directly to the Prime Minister on the decision-making process, the situation and the results of implementation of objectives and tasks of the specialized agency; clearly define the mechanism of providing public and transparent information to other agencies such as the National Assembly, party agencies, Vietnam Fatherland Front, and the public, especially mass media organizations.

128. The afore-mentioned supervising and monitoring mechanism applied to specialized agency will certainly be much clearer, easy to implement, inexpensive, efficient and effective than the current mechanism of scattered and fragmented supervision of various line ministries.

<u>(iii) It is necessary to design an operational mechanism of specialized agency aiming at improving the efficiency and effectiveness of management and supervision in order to preserve and maximize the value of state capital and assets invested in enterprises:</u>

129. The specialized entity is not a state management agency, so it will not comply with objectives, values, principles and tools as other state management agencies. In contrast, to preserve and maximize the value of state capital, the operations of specialized entity must have the nature of investment and business activities, which are far different from administrative management modality of the current state-ownership representative agencies, firstly in terms of accounting regime and personnel arrangement.

130. Managers and staffs of specialized entity must have rich knowledge and experience of investment and business, including international investment and business; and must possess the analytical and assessing skills of financial investment, risk management, etc., and are not civil servants.

131. The selection and appointment of leaders, the recruitment of staff for the specialized agency must also be fundamentally different from those of civil servants, and have to rest mainly on professional competence and achievements in business. The dismissal and fire of managers or staffs of specialized agency

are on similar basis: the staff are fired or dismissed simply because of failure to fulfill the planned targets regardless of the reasons, etc.

132. Thus, the specialized agency is more or less similar to a holding company that manages assets and financial investment in terms of strategic goals, financial and non-financial indicators, ways of administration and management as well as management tools, evaluating work performance, wage mechanisms and policies, etc. Accordingly, remuneration of managers of specialized agency is not based on the payroll applied to state employees, but should be based on the level generally afforded by the business community.

133. Given the above-mentioned operational mechanism and requirements of managers and staffs of specialized agency, together with the expectation of increasing value of state capital and assets through improving management and supervision of a specialized and professional apparatus, the benefits will be much greater than the costs of establishing a new agency, including the additional staffing costs.

134. *In summary*, the establishment of a specialized and professional entity to manage and supervise the state capital and assets invested in production and business activities is essential for developing a full, modern and integrated market economy, which is also expected to produce significant positive impacts on the economy in the long-term. However, in reality, the risks and challenges persisted on the establishment and operation of the agency. Such risks and challenges come mainly from resistance to proposed changes in the power and interests in management and supervision of SOEs and the state capital invested in enterprises. To overcome these challenges, it is crucial to have a meaningful efforts and political support of leaders of the State and the Government and the support of the business community of all economic sectors, as well as of other stakeholders, particularly representatives of the people, the press and mass media organizations.

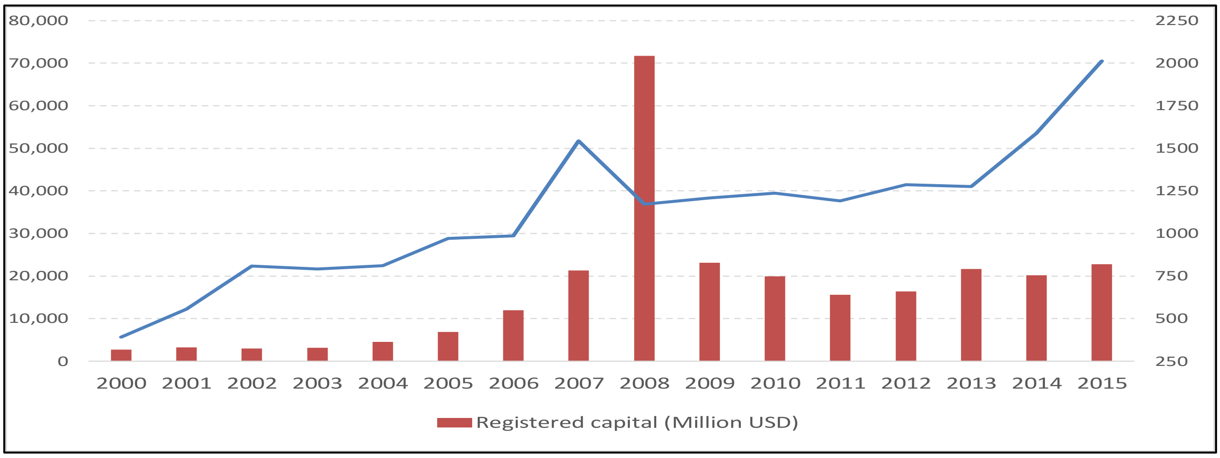
3. *Minimizing environmental impacts of FDI*

135. FDI sector has achieved remarkable growth rate in recent years. Despite fluctuations in some specific periods, the number of projects and registered capital still resembled an upward trend in the period of 1988-2015. By 31st December 2015, there were 20,069 projects in effect, with total registered capital of USD 281.8 billion (including newly-registered and supplemented capital). On the average, the FDI sector accounted for 25% of gross investment from 2011 to 2015 (Foreign Investment Agency, 2016). In the first 6 months of 2016, FDI inflows to Vietnam continued to rise.[52] Consequently, the FDI sector has significantly contributed and become more important to Vietnam's economy, enhancing competitiveness of domestic enterprises, creating jobs, improving technological and domestic management skill through some "spillover" effects. Besides, FDI firms have attracted satellite investors that

[52] See sub-Section 1.4, chapter II about investment.

help facilitate industrial development and strengthen opportunities to participate in GVCs and access to international markets for domestic firms.

Figure 43: Number of projects and total registered capital of FDI in Vietnam, 2000-2015



Source: GSO.

136. Notwithstanding remarkable contributions to the economy, investment in general and FDI in particular may create environmental impacts. At the initial stages, developing countries tended to relax environmental standards in order to compete with other nations in attracting FDI capital. Yet FDI, especially heavy industries and mining projects, may cause adverse environmental impacts on less developed countries (OECD, 2002). Thus, FDI recipients actually accepted some industrial projects causing pollution which were not permitted for implementation in home countries. The nature of investment sector is important to environmental impacts. Yue S. *et al* (2016) on impacts of FDI on environmental in China showed that environmental efficiency of FDI in China mainly depends on the pollution and emission levels of invested industries, while the “spill-over effects” of transferring clean technologies and environmental technologies is only modest. This is a useful lesson for developing countries, including Vietnam. As an implication, the rejection of potentially environmentally-polluting FDI projects may be more important and create greater impacts than the capacity improvement for using clean and environmental technologies.

137. In Vietnam, FDI mainly focuses on assembling industries with low value-added while there are few projects in infrastructure. The proportion of AFF projects is limited and takes the downward trend despite Vietnam’s significant comparative advantages. FDI projects on intermediary and high value-added services such as education, healthcare, environmental services, etc. remain modest (Foreign Investment Agency, 2013). Recently, FDI inflow into Vietnam has shifted towards energy-consuming, natural resource intensive, labor intensive and environmental unfriendly industries such as ship repairing, mineral mining and exploitation without a linkage with deep processing, paper powder production, chemical production, agricultural processing, etc.; despite the lack of environmental control mechanisms in many provinces (Dao Quang

Thu, 2013). On the one hand, thus, Vietnam should create a more attractive investment environment by eliminating administrative and institutional barriers. On the other hand, it is necessary to comprehensively disseminate information on and strictly regulate the compliance with environmental protection regulations, in order to select good investors who pays attention to environmental protection upon investing in Vietnam.

138. Most FDI projects in Vietnam use medium-level technologies (above 80%) instead of advanced and modern ones in relative to available technologies in the world. Few FDI firms apply advanced technologies (5-6%), some adopt low and outdated ones (about 14%). A small number of firms use outdated technologies.[53] Technology transfers, if any, are often horizontal, i.e. business-to-business (Dao Quang Thu, 2013). Hence, technological level of FDI projects in Vietnam only pertains to the world's average low level. Those technologies are mostly energy-consuming and create more greenhouse gas emission than the world's average level.

139. Provisions on environmental protection are specified in many legal documents, creating a legal framework to mitigate environmental impacts caused by enterprises in general and FDI firms in particular on Vietnam's economy. Key legal documents include the Investment Law in 2014, the Law on Environmental Protection in 2014, the Law on Environmental Protection Tax in 2010, the Minerals Law in 2010, the Law on Corporate Income Tax in 2013, the High Technology Law in 2008, the Law on Water Resources in 2012, the Petroleum Law in 2008, the Law on Economical and Efficient Use of Energy in 2010, etc. as well as various decrees and circulars guiding the implementation of these laws. Those legal documents have different regulations depending on enterprises' operation phases. In details:

a. At the business registration phase: the 2014 Law on Environmental Protection stipulates the industries that are prohibited for environment concern. The 2014 Investment Law specifies conditional business areas. Annexes of these laws include detailed lists of all prohibited and conditional business activities, including those related to environment. In addition, the 2014 Investment Law contains some incentives to investors that may positively affect the environment. Investment incentives are applied to advanced and supporting technological activities and products, R&D, new materials, new and clean energy, renewable energy, manufacturing industries that create the minimum of 30% of added-value, energy-saving products, the collection, treatment and recycling of waste. Besides, preferential treatments regarding environmental protection are also granted to investment projects within industrial parks (IPs), processing zones, high-tech parks and economic zones.

b. At investment preparation and construction phase: the 2014 Law on Environmental Protection 2014 requires investors to conduct environmental

[53] Report by the Ministry of Science & Technology to the Prime Minister (document No. 2538/DA-BKHCN dated 7/9/2012).

impact assessment (EIA) and develop environmental protection plans to be approved by authorized agencies. The list of projects subject to EIA is identified in Appendix II of Decree No.18/2015/ND-CP stipulating strategic environmental assessment and environmental impact assessment. Upon the approval of EIA report, investors must revise their proposals to be consistent with the decision on approving EIA report, and implement all environmental protection measures during the preparation and construction phase based on the content of the EIA approval decision (design and application of environmental infrastructure, including treatment of waste water, toxic and non-toxic, dust and emission, etc.).

c. At operation phase: enterprises in general and FDI firms in particular must comply with a number of regulations on environmental protection and sanctions for breaching legal provisions; and receive support and incentives if their manufacturing and businesses have positive impacts on the environment. Although environmental policies generally suffice to adjust firms' operations, the compliance with those regulations/policies remains inadequate. Besides, some environmental regulations of Vietnam are irrelevant to actual situations, while environmental appraisal of FDI projects is only document-based, superficially approached and mainly focuses on *ex ante* inspection (Dao Quang Thu, 2013).

140. In general, FDI enterprises' compliance with environmental regulations is relatively good, reflecting in results of several surveys. By the end of July 2015, 187 out of 299 industrial parks had fully established sewage treatment system for operation, accounting for 62% of established industrial parks and above 88% of active industrial parks.[54] The Ministry of Natural Resources and Environment issued specific regulations on the maximum level of pollution indices of industrial sewage discharged into the waste-water system.[55] Regarding the current sewage volume of 187 IPs (approximately 350,000m^3/day), waste water treatment plants are capable of handling the existing volume of sewage from the IPs. For the remaining plants, waste water is internally treated and required to satisfy type B (ISO 24-2009/MONRE, column B) before being pumped into the environment.[56] According to the survey by CIEM and MUTRAP in 2015 in Bac Ninh province, 85-90% of FDI firms in the province had regular and timely reports on the environment quality; only 5-7% breached environmental regulations, which were mostly in the form of miscomplying with administrative procedures on reporting changes of environmental management system (CIEM-MUTRAP, 2016). This rate is relatively high compared to the overall situation of the business sector.

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[54] http://khucongnghiep.com.vn/dinhhuong/tabid/65/articleType/ArticleView/articleId/1393/Default.aspx

[55] Circular No. 47/2011/TT-BTNMT on 28/12/2011 by MONRE on national environmental technical standards.

[56] http://khucongnghiep.com.vn/dinhhuong/tabid/65/articleType/ArticleView/articleId/1393/Default.aspx

According to a survey by the National Centre for Socio-economic Information and Forecast (NCIF) in 2014, 36 out of 39 FDI firms had specialized departments or staff being in charge of environmental issues. Most FDI firms must comply with environmental protection commitments, conduct EIA reports or develop environment protection project under provisions of Vietnam's regulations (NCIF, 2014).

141. Although the compliance with environmental regulations of FDI firms has been improved, some IPs and firms located inside the IPs have not strictly followed environmental regulations. Cooperation on environmental inspection and monitoring among State agencies is inadequate. Despite increasing number of waste water treatment plants, some indicators of sewage of surrounding areas of IPs in some provinces exceeded the maximum allowable levels, as reported by the IPs' management unit (Vu Dai Thang, 2013). It can be attributed to the operations of sewage treatment plants, which fail to strictly comply with regulations. Meanwhile, managerial and supervisory agencies lack equipment and human resources, leading to limitation of inspection and monitoring process, inadequate sanctions. Not all FDI firms are able to identify harmful waste and its effects on the environment. Out of 15 businesses to be surveyed by CIEM and MUTRAP (2016), only 10 were able to describe in details production activities and the sewage discharged at different stages of production; and the rest can only provide general descriptions, incapable of identifying types of wastes to be created. Hence, not all FDI enterprises having environmental specialized staff have fully understanding of the production process and emission sources. This may affect the waste management and other problems related to the environment.

142. FDI firms mainly focus on post-production waste treatment. Environmental pollution would be better handled if those firms invest in pre-production measures to prevent pollution, such as clean technologies, solid waste and sewage treatment systems, etc. In fact, FDI firms have paid insufficient attention to this matter during the preparation stage. According to CIEM-MUTRAP (2016), only 2/3 of surveyed FDI firms declared that they estimated environmental costs while developing investment plans. More than half of those enterprises confirmed that they allocated budgets for environmental costs; only 2 firms indicated no adequate awareness/thorough understanding about environmental issues as well as sufficient budget allocation for environmental protection. Likewise, IPs management boards informed that FDI firms mostly invested in post-production waste treatment while ignoring pre-production environmental protection measures, according to NCIF (2011).

143. A typical case is the Hung Nghiep Formosa Ha Tinh Iron and Steel Ltd. Co. (Taiwan) located in Vung Ang economic zone, Ha Tinh province, which caused severe environmental incident in April 2016. This incident led to mass fish deaths in four provinces of Ha Tinh, Quang Binh, Quang Tri and Thua Thien-Hue. After 3 months of inspection, the Government officially concluded (on June 30th, 2016) that Formosa Ha Tinh was the source of the environmental pollution incident, resulting in a bizarre mass killing of fish and aquatic species

in 4 central coastal provinces. The incident happened during the trial operation of the plant complex. At the appraisal stage of Formosa project in 2008, FDI projects were subject to appraisal regulations under the Decree No. 108/2006/ND-CP dated September 22nd 2006 guiding the implementation of the Investment Law 2005. Accordingly, the approval of Formosa project was decentralized to the provincial people's committee while ministries and industries only took part in the appraisal process. Appraisal report of the Ministry of Planning and Investment on this project stated that the EIA report was sketchy and did not mention such issues as environmental impacts, affected objects, and the scope/scale of impacts or measures to settle negative impacts and prevent environmental risks. MPI also requested the investor to conduct EIA report and submit to the relevant authority for approval.[57] As such, warnings of the potential risk of environmental pollution from the project were emphasized at the appraisal stage. According to the Minister of Natural Resources and Environment, "*Formosa admitted that there was a short-circuit accident at the microbial activation operation in the sewage treatment process. This was an essential stage of phenol treatment. The accident paralyzed the system, leading to the discharge of untreated sewage into the environment*".[58] On the one hand, a large volume of untreated waste water discharged into the environment reflected the irresponsibility of Formosa; on the other hand, it reflected the shortcomings of the State management concerning the inspection and monitoring of sewage to be discharged into the environment by industrial manufacturing factories, especially large enterprises in such industries that are highly likely to cause environmental pollution. Formosa has admitted its mistake, promised to compensate the amount of USD 500 million and been committed against repeating the mistake.[59] However, a number of issues still have to be addressed to overcome this serious incident, such as accurately assessing the extent and scale of impacts; identifying specific measures to restore the marine environment and livelihood of the people in affected areas; developing mechanisms and plans to monitor the enforcement of Formosa's commitments, especially the commitment on enhancing production technology

[57] http://tuoitre.vn/tin/chinh-tri-xa-hoi/20160630/hop-bao-cong-bo-nguyen-nhan-ca-chet-o-mien-trung/1127815.html

[58] http://infonet.vn/shop-tin-17-thu-pham-formosa-84-ngay-cang-thang-nang-triu-cua-bo-truong-post202640.info

[59] 5 commitments of Formosa: (1) Public apology to the Government of Vietnam and Vietnamese people for causing severe environmental pollution; (2) Compensation for people's losses and assist them in changing jobs, and for restoring marine environment, with total amount of VND 11.5 trillion (equivalent to USD 500 million); (3) Improvement of production technology to thoroughly treat wastes before dumping into the environment, avoiding the same environmental incident; (4) Coordination with Vietnam's ministries, industries and the central provinces to develop consistent solutions to prevent pollution and environmental incidents, strengthen confidence of Vietnamese people and international partners; (5) Strict implementation of above mentioned commitments and avoid the reoccurrence of similar mistakes. Should the incident occur again, Formosa would accept sanctions under Vietnamese legal regulations. [http://tuoitre.vn/tin/chinh-tri-xa-hoi/20160630/hop-bao-cong-bo-nguyen-nhan-ca-chet-o-mien-trung/1127815.html].

to thoroughly/fully treat sewage before discharging into the environment and avoid the same environment incident.

144. Vietnam still needs to further improve environmental policies, in particularly strengthening enforcement and efficiency. In particular:

a. Further improve environmental protection policies and regulations toward greater clarity and stability. This will help FDI firms overcome difficulties in implementing environmental regulations which are currently sophisticated and ambiguous. Both FDI and domestic firms find that guiding documents of legal regulations are insufficient, issued at delay and frequently amended. Government agencies should timely and appropriately inform enterprises of any amendment, adjustment or supplement. An official information dissemination system should be set up to help FDI firms update information of policies and requirements from the authorized agencies.

b. Both *ex ante* and *ex post* inspection and monitoring of environmental issues should be implemented on FDI projects in particular and investment projects in general. As an implication, inspection and supervision on firms' compliance with environmental standards and regulations should be applied to all stages of FDI investment in Vietnam. Thus, an environmental inspection system and a laboratory capable of assessing environmental impacts are needed. In addition to sewage and solid waste pollution, air pollution may become a serious problem soon while Vietnam lacks a fully-developed and effective survey and inspection system at all levels.

c. Enhance the capacity of environmental management in compliance with requirement of Vietnam's regulatory system. This is a crucial requirement for Vietnam to achieve sustainable development in the near future. Capacity building is not only for environmental management staff of authorized management agencies, but also for personnel in charge of environmental issues at enterprises. Contents of trainings should focus on the most fundamental issues such as: identifying emission sources at each production stage, checking side products, monitoring and controlling sewage quality before being discharge into the environment, etc.

d. Improve coordination between environmental management agencies, including environment police, departments of natural resources and environment at provincial level, IPs' management board, etc. to avoid overlapping functions in monitoring compliance with policies and regulations of enterprises in general and FDI firms in particular. This helps enterprises reduce the burden of being inspected by various authorities, simultaneously enhancing efficiency and saving costs of environmental inspection.

IV. RECOMMENDATIONS

145. The new governmental apparatus has promptly engaged in socio-economic management, together with accelerating reforms of microeconomic foundation. Meaningful policy changes were noticeable. The very first Resolutions of the new Government emphasized the needs to improve business environment, supporting enterprises, reviewing and simplifying investment-business conditions. Feedbacks of the business community on related issues have been promptly received, incorporated and explained. Moreover, members of the Cabinet directly instructed and quickly addressed problems and behaviors that might breach legal regulations on environment or weaken the freedom to do business, etc. Those attempts attained even more importance in Q2, for Q1 only witnessed slow microeconomic reforms and a sluggish private sector. Such changes lived up to expectations of the business community and citizens, putting them as central target of the policy framework.

146. Being less impressive than expected, the socio-economic outcomes in Q2 could hardly overshadow the tremendous attempts of the Government. In fact, ample difficulties and volatilities continued to have material impacts on the global and regional economy in Q2. Inherent shortcomings of Vietnam's growth paradigm also take time to resolve. Still, Vietnam's economic growth and export expansion outpaced other countries in the region. Hence, targeting high economic growth at all costs is hardly justified. Instead, the Government should be determined in prioritizing microeconomic reforms, sustaining and building policy space for macroeconomic management. The responsive Government, thus, should go beyond addressing specific issues so as to focus more on concretizing the policy framework for economic development, resting on appropriate reforms, meaningful participation of the business community and the "rule of law" in Vietnam.

147. Ample risks still prevail in the economic context of Q3. The international economic integration process still plays the dominant role, and is virtually irreversible. Nonetheless, Brexit led to major uncertainties of the global context, policies of countries in the world and responses of investors. Such uncertainties may have more rapid and stronger impacts on Vietnam. To that extent, the Government should build up additional space for macroeconomic policy to address emerging issues (if necessary).

148. In this context, the policy recommendations to improve microeconomic foundation and macroeconomic policy management – as per preceding Macroeconomic Reports of the CIEM – remain valid. The following recommendations are meant for consideration in Q3 and the last 6 months of 2016.

1. Recommendations on further reforms of microeconomic foundations in Q3

149. Promptly concretize the directions for economic restructuring and shift of growth paradigm, associated with a more targeted industrial policy, taking

advantage of scientific-technological innovation and improvement of labor productivity.

150. Seriously and effectively implement the Resolution No. 19/NQ-CP on key tasks and measures to further enhance business environment, and the Resolution No. 35/NQ-CP on supporting firms. Periodically review outcomes and shortcomings in order to address promptly.

151. Continue to guide the implementation of the (amended) Investment Law, (amended) Enterprise Law, etc. Seriously and prudently remove outdated and illegitimate business conditions – based on regular dialogues with relevant stakeholders; simplify remaining business conditions.

152. Review and develop roadmap to gradually reduce discriminatory and differential treatments that may affect competitive neutrality between SOEs and the private sector.

153. Proactively review and discuss with partners about the criteria of a market economy that Vietnam should better satisfy. On that basis, Vietnam should develop plans and roadmap to have itself recognized as a market economy.

154. Accelerate the revisions of legal documents and other preparatory measures to implement important FTAs. During this process, regular consultations and dialogues with the business community and citizens play a crucial role.

2. Recommendations on macroeconomic policies

* *Monetary policy*

155. Monetary policy should be more prudent, focus on stabilizing inflation in order to anchor expectation and promote economic reform. Avoid excessive stimulus of economic growth via monetary policy.

156. Pay attention to stabilize the VND/USD exchange rate. Continue to monitor changes of exchange rate, interest rate and capital flows in the international market in order to have appropriate responses and/or communication measures.

157. Continue to assign highest priority to fundamentally restructure commercial banks. Promptly prepare plans to further resolve NPLs and improve the balance sheets of commercial banks. Avoid administrative interventions to reduce lending interest rate.

158. Discuss and propose recommendations to the Government and related agencies to reduce credit fragmentation which prevents credit reallocation from ineffective sectors/industries to more effective ones.

159. Monitor and ensure liquidity to support banking restructuring and manage capital flows (inflows, outflows). Provide less support to Governmental bond issuance. Keep reserve requirement ratio unchanged (on both USD and VND). Continue to monitor and regulate USD-denominated lending rate in the interbank market and disseminate information to the market.

160. Avoid administrative restrictions on the participation of commercial banks in Governmental bond bidding.

161. Proactively propose to stop examining the mechanism to mobilize gold held by the people.

* *Fiscal policy*

162. Retain the pace of collecting State budget revenues in Q3 in line with plan. Keep fees and charges unchanged; avoid excessive, advanced or supplemented collection of taxes and fees without reasonable justification.
163. Discipline state budget expenditures; reduce recurrent expenditures together with reducing permanent staff under public payroll.
164. Simplify procedures, reduce time for tax payment and tax refund for enterprises. Consider to relax or shorten schedule of tax inspection.
165. Be prudent in disbursing investment from Government bonds, with serious consideration of project feasibility and efficiency.
166. Consider to cease issuance of Government bonds with terms to maturity of less than 5 years.
167. Develop and publicize medium- and long-term plan to repay public debts, in order to build confidence and enhance sustainability of public debts.

* *Trade policy*

168. Continue to solve barriers and unnecessary procedures that may restrain trading and manufacturing activities.
169. Cooperate trade promotion with investment promotion to favor Vietnamese enterprises to widely and more effectively participate in regional and global value chains. Simplify procedures to enable enterprises to utilize preferential tariff under FTAs.
170. Consider measures to control import and promote exports in association with requirements of food safety and sanitation, environment or technical standards. Direct import and export activities to production means in order to upgrade domestic manufacturing capacity and/or export competitiveness.
171. Cooperate with partners to accelerate negotiation of related FTAs (such as RCEP, FTA with Israel, etc.). Consider to discuss with partners from the U.K. and EU to get more information on the context and perspectives after Brexit.
172. Enhance information dissemination and capacity building for enterprises in line with the scope and schedule of commitments of signed and pending FTAs.

* *Price policy-salary*

173. Consider to reschedule the roadmap for adjusting fees for education and healthcare services.
174. Consider to adjust regional minimum wage in 2007 at low level (should be 4% relative to 2016) to avoid material pressure on inflation expectation.
175. Do not disseminate information or propose recommendation on adjusting wage of staff under public payroll scheme.

** Other related recommendations*

176. Consider to introduce information strategy of food safety and sanitary, avoid excessive impression of dirty food and adverse impacts on production/competitiveness of agricultural sector in Vietnam.[60]

177. Regularly consult foreign investors to understand actual situation, their needs and problems to be solved.

178. Continue to examine and improve statistical data to support macroeconomic management. Enhance the accountability of statistical data, in particular trade data.

179. Cooperation between fiscal and monetary policies require more active stance of the former, particularly in terms of reducing expenditure, relaxing pressure on government bond issuance./.

[60] Lesson of "lemon market" (See Akerlof 1970).

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APPENDICES

Appendix 1: Notable policy adjustment in Q2/2016

No.	Content	Policy adjustment until the end of June 2016
1	Fiscal policy	*Objectives: Stabilize state budget and phase out current expenditure.* 1. Resolution No. 33/NQ-CP of the Government on the regular meeting of the Government of April 2016 (held on 9 May 2016: • Assign tasks for the MOF to implement fiscal policy strictly and actively; be in charge of and cooperate with the SBV to identify the volume, time and interest rate of government bond issuance; ensure macroeconomic balances and public debt safety threshold; guide state budget collection, expand tax base, strengthen inspection activities to fight against tax loss, transfer pricing, and tax debts; consistently reduce current expenditure 2. Order No. 21/CT-TTg of the Prime Minister on developing Socio-economic development plan and state budget estimation for 2017, taking effect from 2 June 2016 • Target of state budget revenue/GDP ratio is about 20 - 21%. Average growth rate of domestic revenues is at least 13 - 15% in relative to actual figure of 2016. Estimated revenues from exports and imports is expected to attain the average growth rate of at least 5 - 7% compared to the implemented figure of 2016. • Investment from the State budget in 2017 should support objectives and tasks of socio-economic development plan in 2017, socio-economic development plan for the 5-year-period of 2016 - 2020 and the Socio-economic development strategy in the 10-year-period of 2011-2020 • Estimation of recurrent expenditure should be consistent with the saving orientation, being accompanied with the reduction of the number of regular staff in the state sector, restructuring of the administrative system in the period of 2016-2020 as specified in the Resolution No. 39-NQ/TW of the Politburo; minimizing costs of organizing conferences, seminars, festivals, study tours abroad, purchase of expensive cars and other facilities.
2	Monetary policy	1. Decision No. 2525/QĐ-TTg dated 31 December 2015 of the Prime Minister approving state investment plan in 2016 2. Circular No. 214/2015/TT-BTC dated 31 December 2015, taking effect from 14 February 2016 of the MOF guiding mechanism and preferential policies related to support from the state budget, tax and credit for state investment in line with the Decision No. 1193/QĐ-TTg dated 20 July 2015 of the Prime Minister.

3	Restructuring of commercial banks and resolving NPLs	*Keen on resolving NPLs and improving governance of commercial bankings using international standards* 1. Resolution No. 142/2016/QH13 dated 12 April 2016 of the National Assembly on the 5-year socio-economic development plan for the period of 2016-2020 • Keep pursuing the restructuring the financial market to ensure a rational structure among monetary market, capital market and insurance market. Focus on developing capital market and insurance markest, develop a sound exchange market in association with restructuring the monetary market. Enhance efficiency of insurance products, broadly implement agricultural production insurance. Continue to restructure credit institutions associated with resolving NPLs, ensure soundness of the banking system, to implement international standardized practices of banking governance.
4	Trade policy	1. Decision No. 1656/QD-BCT dated 29 April 2016 of the MOIT related to outcomes of the first review of anti-dumping measures imposed on selected imported cold-flattened stainless steel products • Impose anti-dumping duty on selected steel products of Chinese, Indonesian and Taiwanese producers/exporters. 2. Decision No. 862/QD-BCT dated 10 March 2016 on imposing temporary safeguard measures on billet and bar steel imported to Vietnam under the following HS classification: 7207.11.00; 7207.19.00; 7207.20.29; 7207.20.99; 7224.90.00; 7213.10.00; 7213.91.20; 7214.20.31; 7214.2041; 7227.90.00; 7228.30.10; 9811.00.00.
5	Price policy	*Objective: Stabilize domestic service prices, control inflation at 4% - 5%.* 1. Announcement No. 107/TB-VPCP of the Office of the Government on conclusion of Deputy Prime Minister Vuong Dinh Hue – Head of the Steering Committee on Price Management at the meeting of the Steering Committee on 23 May 2016 concerning price management of essential products, included: • Petrol: The MOIT is in charge of, cooperates with the MOF and related agencies to regulate petrol price in compliance with market mechanism with state management according to Decree No. 83/2014/NDĐ-CP dated 03 September 2014 of the Government on petrol trading; develop scenarios of price management in line with changes of international prices, price management is associated with using petrol price stabilization fund to stabilize price of this product, aiming at restraining the impact of price increase on inflation. • Electricity: The MOIT guides Electricity of Vietnam (EVN) developing and examining scenarios of electricity price adjustment that include specific details of production price, selling price, profits and losses, pending items and report to the Prime Minister. • Price of healthcare service: The MOH develops plan on adjusting price of healthcare services, forecast price

		adjustment scenarios that may affect CPI. • Price of education service: The MOET is in charge of and cooperates with the MPI to examine impacts of raising price of education services on CPI; continue to cooperate with other ministries and provinces to manage price of education services in 2016-2017 under a rational roadmap. • BOT transport fees: The MOT reviews and evaluates outcomes of 5-year-implementation of collecting BOT fees; reviews, accurately and appropriately calculate production price, investment cost of BOT project national-wide. In the short term, should keep BOT fees unchanged, and lengthen maximum operation duration of BOT collection stations.
6	Improving business environment	*Continue to implement measures on improving business environment and reducing costs of starting businesses.* 1. Order No. 21/CT-TTg of the Prime Minister on developing Socio-economic development plan and state budget estimation for 2017, taking effect from 2 June 2016 • Continue to implement measures on strengthening business environment specified in the Resolution No. 19/NQ-CP dated 18 March 2014, Resolution No. 19/NQ-CP dated 12 March 2015 and Resolution No. 19-2016/NQ-CP dated 28 April 2016 of the Government, aiming at creating the most favourable conditions for business-investment activities, minimizing costs of starting businesses, reducing input costs, encouraging technological innovation, enhancing competitiveness of enterprises. 2. Decision No. 1134/QD-BTC of the MOF approving the action plan to implement Resolution No. 19-2016/NQ-CP dated 28 April 2016 of the Government on key measures and tasks to improve business environment, enhancing national competitiveness in 2016-2017 and orientation to 2020. i. Improve the legal framework: - Develop, amend, supplement the legal documentary system detailing the Law on import and export duties, including 14 decrees and 01 circular. - Develop, amend, supplement the legal-normative documents detailing the Law on Customs, including 02 decrees, 01 decision of the Prime Minister and 01 circular. - Develop legal normative documents guiding the implementation of the National Single Window, including 01 decision of the Prime Minister and 02 circulars. ii. Improve the National Single Window, ASEAN Single Window: - Develop the master plan to implement the Single windows for the period of 2016-2020.

		- Strengthen and expand the scope of administrative procedures to be officially connected to the National Single Window. - Increase the number of administrative procedures in line with registration list of ministries, industries. - Implement e-payment via the National Single Window. - Implement e-documents (e-license, e-certificate and other corresponding e-documents) to be issued via the National Single Window in dealing with other related administrative procedures. i. Taxation: - In 2016-2017, ensure that about 95% of enterprises to implement the 4-level of tax declaration and tax payment; implement electronics from the General Department of Taxation to provincial department of taxation; switch from documentary receipts to electronic ones. - Develop and implement plan to apply electronic tax declaration and e-tax payment for individual business. 3. Joint circular No. 01/2016/TTLT-BKHĐT-BTC dated 23 February 2016 of the MPI and MOF guiding information exchange between the national information system of business registration and information system of taxation. • The MPI cooperates with the MOF to develop the national information system of business registration and tax payment. Specifically, the two Ministries establish an information website that includes directories for joint management. As the result, enterprises can receive their business code for tax payment right after the completion of business registration process and vice versa. Interactions in a single website help enterprises save time and cost.

Appendix 2: Selected macroeconomic indicators

	Unit	2011	2012	2013				2014				2015				2016	
				I	*II*	*III*	*IV*	*I*	*II*	*III*	*IV*	*I*	*II*	*III*	*IV*	*I*	*II*
GDP growth rate																	
Overall	%	6.2	5.2	4.8	5.0	5.5	6.0	5.0	5.4	6.4	6.8	6.0	6.5	6.8	7.0	5.5	5.6
Trade																	
Growth rate of exports	%	34.2	18.2	17.5	13.6	14.8	15.6	12.2	15.7	13.6	11.6	8.8	10.6	9.2	4.4	6.6	4.9
-FDI sector	*%*	*40.3*	*33.7*	*27.9*	*28.4*	*26.2*	*23.6*	*18.2*	*16.1*	*37.5*	*28.3*	*18.7*	*21.5*	*22.0*	*9.6*	*10.8*	*7.4*
Growth rate of imports	%	25.8	6.6	14.8	17.0	14.2	18.0	10.4	10.5	14.0	13.7	20.1	14.2	11.6	3.7	-4.0	2.2
- FDI sector	*%*	*32.1*	*22.7*	*26.1*	*25.9*	*25.4*	*19.9*	*14.6*	*7.3*	*8.2*	*24.3*	*27.1*	*20.3*	*18.4*	*1.7*	*-4.5*	*0.0*
Exports/GDP	%	72.6	73.5	89.1	81.4	79.7	65.1	92.8	86.6	82.5	67.7	96.3	92.8	87.0	69.7	99.8	92.4
Money																	
M2 growth (YoY)	%	12.1	18.5	3.8	3.4	2.8	7.7	2.8	4.1	2.9	6.9	2.4	3.6	3.7	5.7	3.1	4.8
Credit growth (YoY)	%	14.3	8.9	1.2	3.5	2.1	5.3	0.5	3.2	3.5	6.3	2.7	5.1	4.0	4.6	3.0	5.0
Interbank VND/USD exchange rate (Average)	Dong	20532	20828	20828	20831	21036	21036	21036	21063	21246	21246	21446	21593	21773	21890	21890	21876
Investment																	
Investment/GDP	%	33.3	30.5	29.6	29.6	33.8	33.2	28.4	31.5	33.0	30.6	30.4	31.7	33.2	33.6	32.2	33.2
Implemented FDI capital	Bil. USD	11.0	10.0	2.7	3.0	2.9	2.9	2.9	2.9	3.2	3.5	3.1	3.3	3.4	4.8	3.5	3.8
Other indicators																	
Inflation (YoY)	%	18.1	6.8	6.6	6.7	6.3	6.0	4.4	5.0	3.6	1.8	0.9	1.0	0.4	0.6	1.7	1.8
State budget deficit/GDP	%	4.9	5.4	5.4	5.0	5.3	4.7	4.9	4.6	5.3	7.3	4.6	6.4	3.9	8.6	5.5	3.7
Current account	Bil. USD	0.2	9.1	2.6	1.3	3.5	1.7	2.7	2.7	2.8	0.8	-1.3	0.7	0.5	1.1	2.6	-
Balance of payment	Bil. USD	1.2	11.9	3.0	-3.3	-0.8	1.7	7.9	2.2	0.9	-2.6	2.7	0.6	-6.6	-2.7	3.5	-

Source: Authors' compilation.