MACROECONOMIC REPORT
THIRD QUARTER - 2014

INTRODUCTION

Vietnam's economy is entering an important stage of its reform process. Notwithstanding improved macroeconomic stability, there remain difficulties affecting the business, production, and investment activities of enterprises. Effective reforms emerge as an important need to ensure rapid and sustainable medium and long term development. However, many policy targets are still to be realized, from the promotion of economic growth, restructuring in important areas, macroeconomic stabilization, resolving bad debt, and pro-active international economic integration. The resources, incentives, priorities and political will for reforms are yet to match practical demand for action. Thus, Vietnam needs in-depth analysis of macroeconomic issues so that priorities can be considered and a clear prioritized roadmap for action can be agreed.

This Macroeconomic Report for the 3rd quarter of 2014 serves several objectives, namely: (i) to update the macroeconomic developments and policy changes in the quarter, with analyses and conclusions on implications; (ii) to assess the economic outlook for the 4th quarter of 2014; and (iii) to make recommendations on macroeconomic policies in the 4th quarter of 2014 and the forthcoming years in line with reform requirements of Vietnam. During preparation of this Report, the authors have received valuable comments and suggestions from experts of the Central Institute for Economic Management (CIEM) and other Ministries and agencies.

On this occasion, the CIEM would like to dedicate special thanks to the Restructuring for a more Competitive Vietnam (RCV) Project for providing technical and financial assistance to the Report.

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The Report is prepared by the CIEM and RCV-funded consultants. The team is led by Dr. Nguyen Dinh Cung, with contributions by Dr. Vo Tri Thanh, Nguyen Anh Duong, Tran Binh Minh and Dinh Thu Hang. The consultants who have provided inputs and data include Dr. Le Tat Phuong and Nguyen Manh Ha.

All remaining errors, views and opinions presented in the Report are solely of the authors and may not necessarily reflect those of the RCV project and/or the CIEM.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY i
I. ECONOMIC CONTEXT IN Q3, 2014 1
1. Global and regional economic context 1
2. Domestic economic context 2
II. MACROECONOMIC PERFORMANCE AND OUTLOOK 4
1. Macroeconomic performance in Q3 4
1.1. Economic growth 4
1.2. Inflation 6
1.3. Money and credit 7
1.4. Investment 10
1.5. Trade 11
1.6. Budget revenues and expenditures 13
1.7. Bad debt 14
2. Macroeconomic outlook 16
III. POLICY ADJUSTMENTS AND RECOMMENDATIONS 18
1. Important policy adjustments in Q3 18
1.1. Policies to support business and production 18
1.2. Monetary policy 18
1.3. Fiscal policy 19
1.4. Trade policy 19
1.5. Market and price management 20
1.6. FDI policy 21
1.7. Coordination of macroeconomic policies 21
2. Policy recommendations 21
REFERENCES 26
STATISTICAL APPENDIX 27

LIST OF TABLES

Table 1: Current situation and prospect of global economic growth.......................... 1
Table 2: Popular deposit interest of commercial banks.. 7
Table 3: Popular lending interest rates of commercial banks...................................... 8
Table 4: Budget revenues and expenditures, 2007-2014.. 14
Table 5: Projection of macroeconomic indicators for 4^{th} quarter and 2014 (%) 16

LIST OF FIGURES

Figure 1: International gold price... 1
Figure 2: Prices of crude oil and food... 1
Figure 3: Exchange rates of USD relative to major currencies 2
Figure 4: GDP growth rate (%).. 4
Figure 5: GDP growth rate by sector (%) 4
Figure 6: GDP structure by ownership, Q1/2007-Q3/2014 (%)................................. 4
Figure 7: IIP, 2013-2014 (%)... 5
Figure 8: PMI, 2012-2014.. 5
Figure 9: Quarterly GDP comparing with trend (VND billion) 5
Figure 10: Growth of final consumption and gross capital formation (%).................. 6
Figure 11: Year-on-year inflation, 2011-2014 (%)... 6
Figure 12: Monthly growth rate of M2 and outstanding credit (%) 8
Figure 13: Movements of VND/USD exchange rate, 2012-9/2014 9
Figure 14: Movements of REER... 9
Figure 15: Ratio of investment over GDP 10
Figure 16: Investment structure by ownership.. 10
Figure 17: Registered and implemented capital of FDI.. 11
Figure 19: Correlation between import and total retail sales of goods and service revenues 12
Figure 20: Contribution of FDI sector on trade and GDP 13
Figure 21: Bad debt ratio released by the SBV, 2013-9/2014 (%) 15
Figure 22: Leading indicator of exchange rate 17

LIST OF BOXES

Box 1: Issues for policy debate... 24

ABBREVIATIONS

AEC	ASEAN Economic Community
ASEAN	Association of South East Asian Nations
CIEM	Central Institute for Economic Management
CPI	Consumer Price Index
EVFTA	EU-Vietnam Free Trade Agreement
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Products
GSO	General Statistics Office
IFS	International Financial Statistics
IIP	Index of Industrial Production
IMF	International Monetary Fund
IPR	Intellectual property right
MRA	Mutual Recognition Agreement
NSW	National Single Window
PMI	Purchasing Management Index
Q3	3rd quarter
Q4	4th quarter
RCEP	Regional Comprehensive Economic Partnership
REER	Real Effective Exchange Rate
ROO	Rules of origin
SBV	State Bank of Vietnam
SOE	State-Owned Enterprises
SPS	Sanitary and Phytosanitary measures
TBT	Technical Barriers to Trade
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
USA	United States of America
VAMC	Vietnam Asset Management Company
VKFTA	Vietnam Korea Free Trade Agreement
YoY	Year-on-year

EXECUTIVE SUMMARY

1. The 3rd quarter (Q3) of 2014 witnessed complicated economic and political movements. Maritime boundary conflicts escalated in Asia. Warfare in the Middle East, mounting conflicts between Russia and the Western countries had significant impacts on economic and trade performance of involved countries and the world economy.
2. The major economies only attained slow and uneven growth recovery. The global economy is forecast to grow by 3.3% in 2014, before recovering more rapidly in 2015. World trade experienced moderate growth. This growth may continue thanks to liberalization commitments in regional and plurilateral FTAs. Structural reforms remain high on many economies' policy agenda toward economic renovation and restructuring.
3. There have been several changes in the domestic economic context. Economic growth improved. Inflation fell below the target of 7.0% for 2014. Restructuring efforts on public investment, SOEs and commercial banks were deepened. Foreign investors continue to express interest in Vietnam's economy.
4. Year-on-year GDP growth rate reached 6.4% in Q3, and 5.6% for the first 9 months. Q3 growth was nearly 1 percentage point higher than in the 2nd quarter. The targeted GDP growth of 5.8% for 2014 can be realized.
5. More rapid growth in Q3 reflected accelerated growth in the industry-construction sector, which grew by 8.3% year-on-year. The shares of the industry-construction, and services sectors, in GDP increased slightly.
6. Economic growth in Q3 failed to substantially strengthen confidence in a robust recovery in business production. Industrial sector value added increased more rapidly than the IIP. Growth in mining and quarrying (crude oil and coal) remained significant. Sales of manufacturing products and new export orders increased slowly. Expansion of gross capital formation was modest.
7. The CPI increased by only 2.4% during the first ten months of 2014. Inflation has stabilized at lower rate than in 2012 and 2013. Price increases were most notable in food and foodstuff, education, and medicines and health services.
8. The VND deposit rate (for terms shorter than 6 months) was stable and lower than the SBV ceiling. Lending rates fell by 0.5-1.5 percentage points per annum compared to the end of 2013. By September 30, outstanding credit grew by 7.26% (compared to the end of 2013). The gap in the USD-VND interest rates induced a sharp increase in foreign currency loans (10.9% in the first 7 months). Extending credits still faced major challenges, namely: (i) poor sales, lack of collateral, and business pessimism over the economic outlook; (ii) debt restructuring and imbalances between loans-deposits in foreign currencies at banks; (iii) lack of market-based instruments to reduce lending rates, and (iv) crowding-out effects of Government bond issuance.
9. The VND/USD exchange rate, both at commercial banks and in the parallel market, tended downwards since mid-July. The exchange rate has become more stable since August. Underlying these variations were: (i) SBV's intervention to

raise the bid rate of USD; and (ii) the purchase of USD by commercial banks to reduce or close their positions. Taking account the changes in domestic and international prices, Vietnamese products became cheaper relative to international products.

10. The domestic gold market exhibited few fluctuations in terms of supply and demand in the. Transactions fell in number because commercial banks have fully closed positions of gold deposits, whilst reducing loans of gold. The gap between domestic and (converted) international price remained sizeable with insignificant change, at approximately VND 4 million/tael.
11. The ratio of investment to GDP fell compared with recent years. Public investment remained one of the main drivers of economic growth. Registered capital of FDI projects attained USD 4.3 billion in the 3rd quarter, and USD 2.5 billion in October. These was a slight increase compared to previous quarters. Implemented capital reached USD 3.2 billion and USD 1.3 billion in Q3 and October, respectively, i.e. equivalent to the first two quarters of 2014. FDI in the real estate sector resumed.
12. Exports and imports grew by 13.4% and 11.2%, respectively (YoY), during the first 10 months of 2014. Exports and imports grew more slowly in Q3 (compared with the first half of 2014, and Q3 of 2013). Export growth could be largely attributed to larger export volume. The major export products included manufactured and assembled goods, crude oil, and fishery. The major markets consisted of the USA, EU, and ASEAN. Import value is closely aligned with the total retail sales of goods and services. China, ASEAN and South Korea accounted for the largest shares of import.
13. FDI enterprises still account for the lion's share shares in exports (67.0%), imports (56.6%) and trade surplus. This sector depends heavily on imported materials for export-oriented production. The contribution of FDI enterprises to the country's GDP was thus small compared with their trade value.
14. Budget revenues were equal to 81.3% of the target for 2014 and 23.8% of GDP during the first 9 months. Budget revenues for 2014 may exceed the target for 2014. Budget expenditures were closely in line with the schedule: the amount in the first 9 months were equivalent to 75.8% of the target for 2014 and 26.9% of GDP. The ratio of budget expenditures over GDP declined steadily.
15. The non-performing loan ratio dropped, from 4.2% in June, to 3.9% in September. By the end of September, about 53.6% of bad debts had been resolved through the collection of debt, auction of collaterals, sales, restructuring and using provision for risk. The bad debt issue is complex, and there remain different viewpoints and assessment on how to resolve the issue.
16. Inflation is forecast to be over 4.6% for 2014. A surplus in the trade balance of USD 1 billion is projected for 2014, a little less than the cumulative surplus for the first three quarters. Export growth accelerated slightly during the 4th quarter to 15.7%. Overall GDP growth for 2014 is projected at 5.9%.
17. The macroeconomic environment has been stabilized and strengthened, accompanied by signs of a recovery in economic growth and improved market confidence. In this context, the policy priority should focus more on improving

business environment, simplifying administrative procedures, reducing costs, liberalizing markets, facilitating business activities, encouraging and improving technological capacity in line with sustainable improvement of productivity. It is high time to encourage and promote entrepreneurship. This will increase enterprise' incentives and development opportunities, thus helping to accelerate the restructuring process and enhance the economy's competiveness. This is the highest priority recommendation in this Report.

I. ECONOMIC CONTEXT IN Q3, 2014

1. Global and regional economic context

1. There were complicated economic and political changes during Q3. Maritime boundary conflicts escalated in Asia. Warfare in the Middle East, mounting conflicts between Russia and the Western countries, all had significant impacts on economic and trade performance of concerned countries and the world economy.

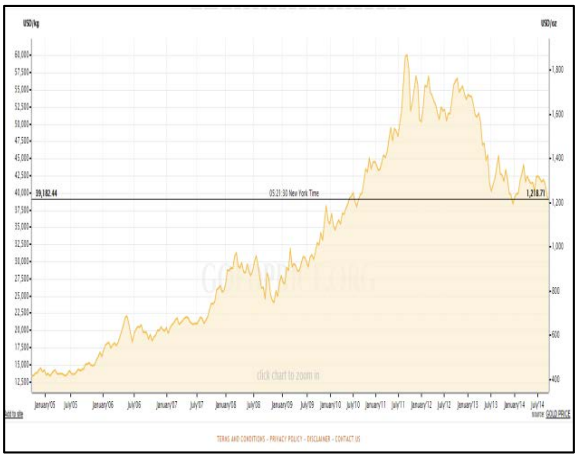
Table 1: Current situation and prospect of global economic growth

	2013		2014		2015
	Q4	*2013*	*Q4*	*2014*	
World GDP (growth rate: %)	3.7	3.3	3.1	3.3	3.8
Advanced economies	2.2	1.4	1.7	1.8	2.3
Unites States	*3.1*	*2.2*	*3.1*	*2.2*	*3,1*
Japan	*2.4*	*1.5*	*0.6*	*0.9*	*0,8*
Euro	*0.5*	*-0.4*	*0.8*	*0.8*	*1,3*
Developing and emerging economies	5.1	4.7	4.5	4.4	5.0
Developing Asia	6.7	6.6	6.6	6.5	6.6
China	*7.7*	*7.7*	*7.5*	*7.4*	*7.1*
ASEAN-5	*4.7*	*5.2*	*5.8*	*4.7*	*5.4*
Global trade (growth rate: %)	-	3.8	-	3.8	5.0
Non-fuel price (% increase, USD)	-2.9	-1.2	-4.3	-3.0	-4.1

Source: Estimations and projections by the International Monetary Fund (IMF, October 2014).

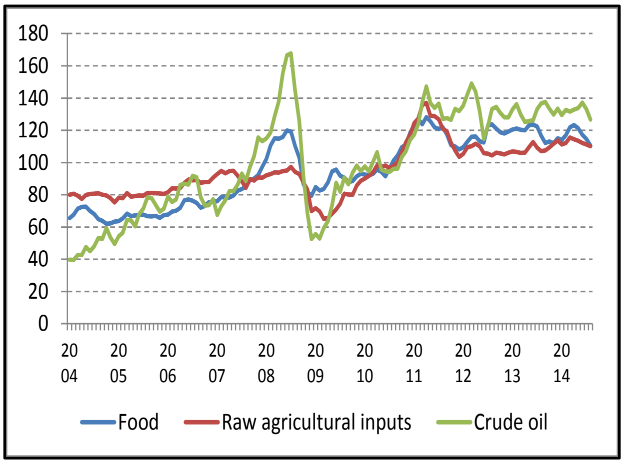
2. The major economies attained slow and uneven growth recovery (Table 1). Growth in developing and emerging economies also slowed. Commodity prices decreased slightly (Figure 1; Figure 2). The USD appreciated relative to major currencies (Figure 3). Investors became more skeptical about investing in developing economies. Many economies have focused on coping with shocks of capital flows, natural disasters, prices, etc.

Figure 1: International gold price



Source: Goldprice.org

Figure 2: Prices of crude oil and food

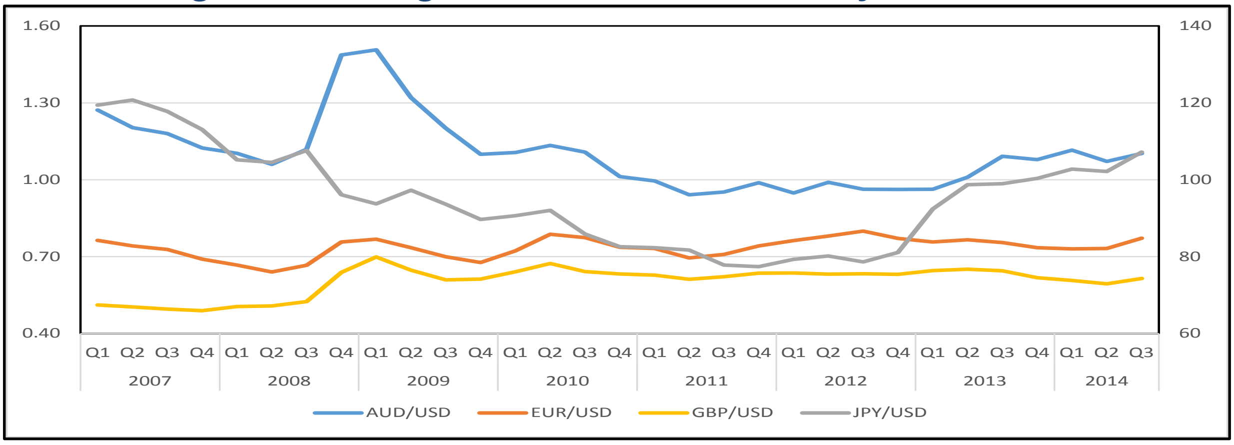


Source: International Financial Statistics (IFS).

3. Economic growth is projected to further recover in 2015. The USA remains the driver of growth recovery. The recovery in EU is still fragile. Japan and China may

experience slower growth. Commodity prices are forecast to reduce. Oil prices remain uncertain because of conflicts and wars, and possible slowing growth in demand in Asia, etc. Appreciation of the USD relative to other leading currencies will be slower.

Figure 3: Exchange rates of USD relative to major currencies



Source: Compilation from various sources.

Note: JPY/USD exchange rate is on the right axis.

4. World trade experienced moderate growth. This growth may continue thanks to liberalization commitments in regional and plurilateral free trade agreements (FTAs). The Trans-Pacific Partnership (TPP) agreement is in the final stage of negotiation. ASEAN and partners are accelerating negotiation of the Regional Comprehensive Economic Partnership (RCEP). ASEAN also deepened efforts towards establishing the ASEAN Economic Community (AEC) by 2015.

5. Structural reforms remain high in the policy agenda toward economic renovation and restructuring. In September, the group of advanced and emerging economies (G20) announced the target to increase economic growth by 1.8 percentage points, with proposals to accelerate infrastructure development, financial reforms and cooperation in tax issues. The growth strategy paid more attention to the aspects of sustainability, innovation and inclusiveness.

2. Domestic economic context

6. Q3 economic growth (6.4%) was higher than in the first two quarters, despite concern about sustainability. Attraction and disbursement of foreign direct investment (FDI) slowed down after labour riots in May. Import growth decelerated. The capacity to mobilize, disbursement and enhance efficiency of public investment capital exhibited slow improvement.

7. The consumer price index (CPI) rose by 2.25% and 2.36% in Q3 and the first ten months, respectively. Such cumulative growth rates remained far below the target for 2014 (7.0%). This situation induced further attempts to loosen monetary and fiscal policies. The inflationary pressures mainly originated from the increases in prices of basic services prices and minimum wages, etc.

8. Demand management remains the dominant approach in formulating macroeconomic policies. However, more ideas of reforms on the supply side and at the micro level were taken into consideration. More policy adjustments were dedicated to reducing difficulties for enterprises, to improve the business

environment via simplifying administrative procedures, to reduce interest rates, and to enhance access to credit and electricity, etc.

9. Some reforms ideas have been spelt out in more detail. The key directions include improving the functioning of, and competition in, the markets, strengthening the regulatory framework for investment and business, increasing discipline over public investment, and restructuring State-owned enterprises (SOEs) and commercial banks.

10. Foreign investors remained interested in Vietnam's economy. The processes of economic restructuring and SOE equitization, and difficulties in production and business broadened opportunities for foreign investors to acquire domestic enterprises.

II. MACROECONOMIC PERFORMANCE AND OUTLOOK

1. Macroeconomic performance in Q3

<u>1.1. Economic growth</u>

11. Year-on-year (YoY) GDP growth reached 6.4% in Q3, higher than the corresponding quarters in 2012 and 2013. The growth rate was nearly 1 percentage point higher that in the 2nd quarter. Overall YoY GDP growth of the first 9 months reached 5.6%. The targeted GDP growth for 2014 (5.8%) can be realized. However, this growth rate remains lower than the average figure for 1990-2010. This resulted partly from the priority for macroeconomic stabilization and partly from the lack of concrete supply-side reforms in recent years.

Figure 4: GDP growth rate (%)

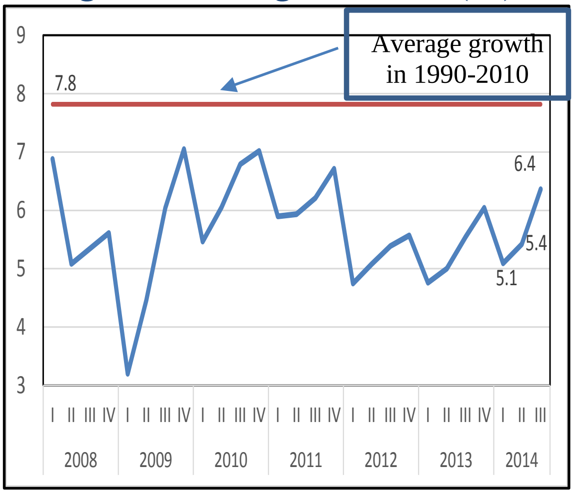
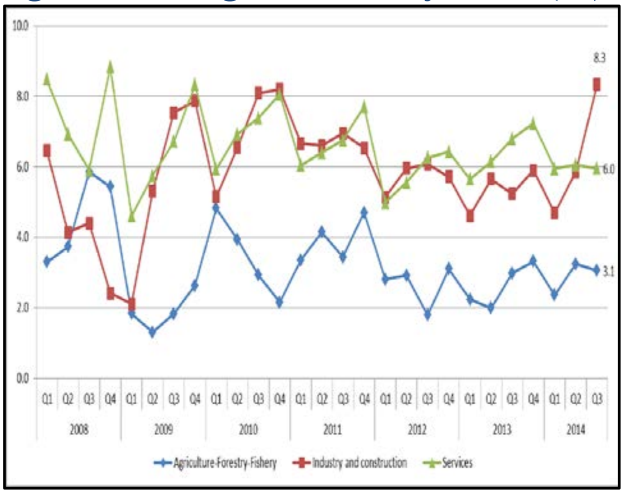


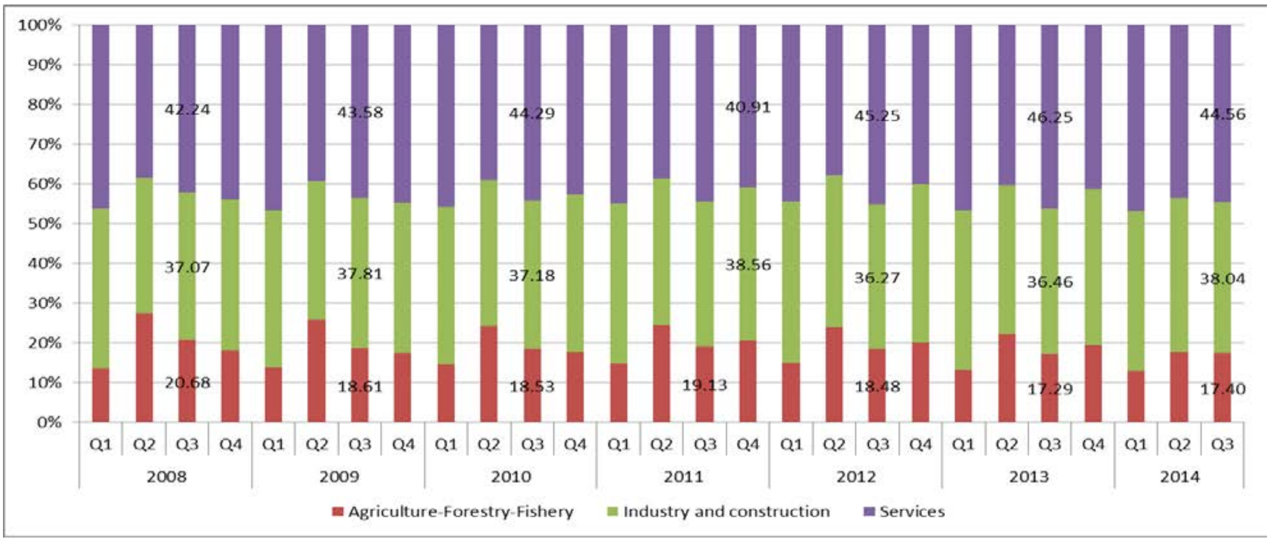
Figure 5: GDP growth rate by sector (%)



Source: General Statistics Office (GSO).

12. Industry-construction had the highest YoY growth rate, attaining 8.3% growth in Q3. Value added of industry increased by 8.2%. The shares of the industry-construction and the services sector rose slightly (Figure 6). The services sector, particularly real estate, financial, banking and insurance sector, grew more slowly.

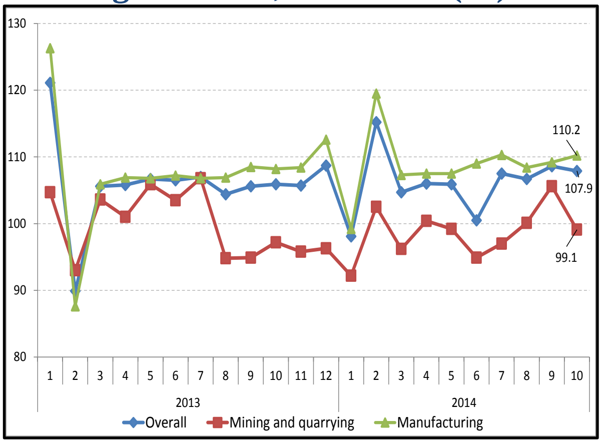
Figure 6: GDP structure by ownership, Q1/2007-Q3/2014 (%)



Source: GSO.

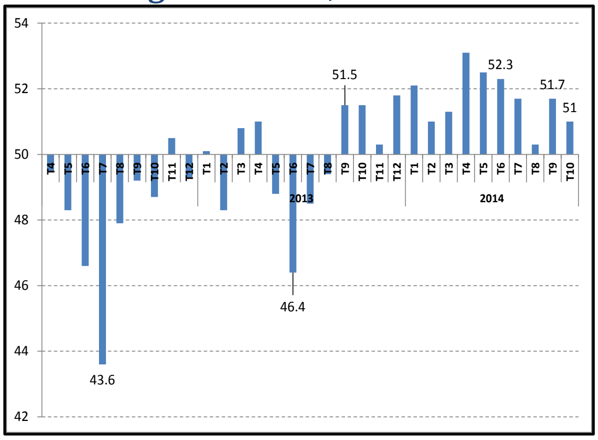
13. Economic growth in Q3 failed to substantially strengthen confidence about robust recovery of business-production. Industrial sector value added grew faster than the IIP. The role of mining and quarrying (crude oil and coal) remained significant.[1] Sales of manufacturing products and new export orders increased slowly. Inventories of manufactured goods rose more rapidly than in the corresponding quarter of 2013. PMI is yet to exhibit sustainable improvement. Despite higher growth of total retail sales of goods and services revenues, the services sector grew more slowly in the first 9 months (YoY).[2]

Figure 7: IIP, 2013-2014 (%)



Source: GSO.

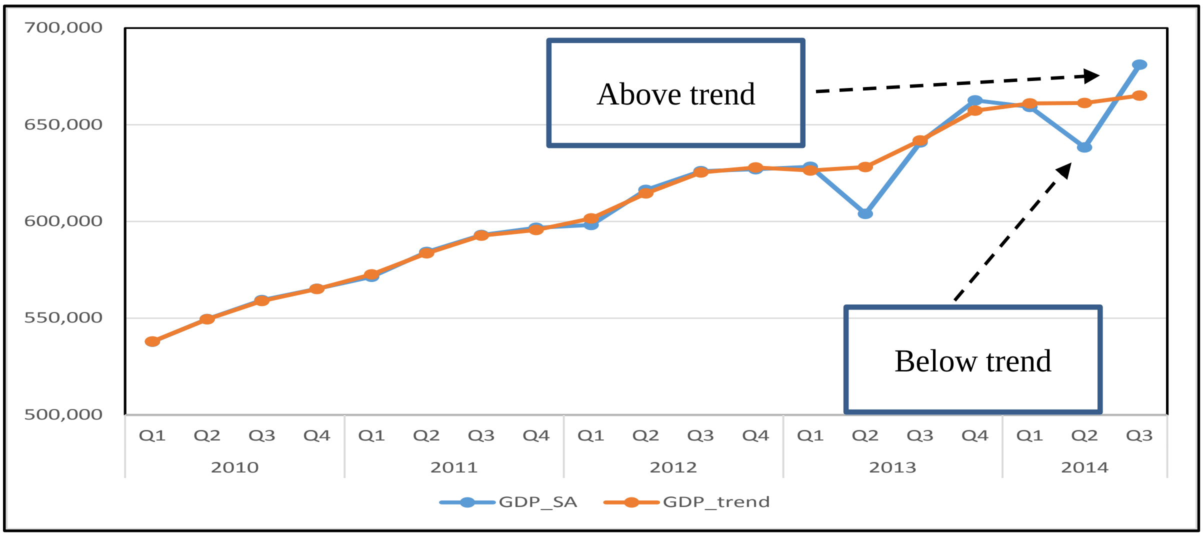
Figure 8: PMI, 2012-2014



Source: Markit, HSBC.
Note: PMI=50 means no month-on-month change.

14. Q3 GDP was above trend, in contrast with the first half of 2014. This suggests that the reforms related to business environment, administrative procedures, etc. so far had few immediate impacts on GDP trend.

Figure 9: Quarterly GDP comparing with trend (VND billion)



Source: Authors' calculation.
Note: GDP_SA is seasonally adjusted GDP; GDP_trend is trend of GDP.

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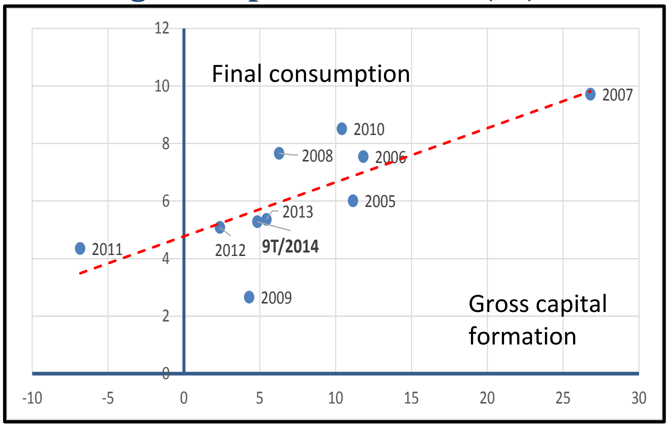
[1] In the first 9 months, revenues of PetroVietnam increased by 19.5% compared with the target; corresponding increase in contribution to the budget was 24%. Output of coal of Vietnam National Coal – Mineral Industries Holding Corporation Limited went up by 2% (YoY); corresponding growth rates of budget contribution and revenues were 10% and 12%.
[2] Respective growth rates (excluding CPI increase) in the first 9 months of 2013 and first 9 months of 2014 were 5.3% and 6.2%.

15. The growth recovery was partly constrained by the slow increase in gross capital formation, which grew by only 4.8% (YoY) in the first 9 months of 2014, slower than in previous years.[3] Challenges to private investment and production are expected to remain.

Figure 10: Growth of final consumption and gross capital formation (%)

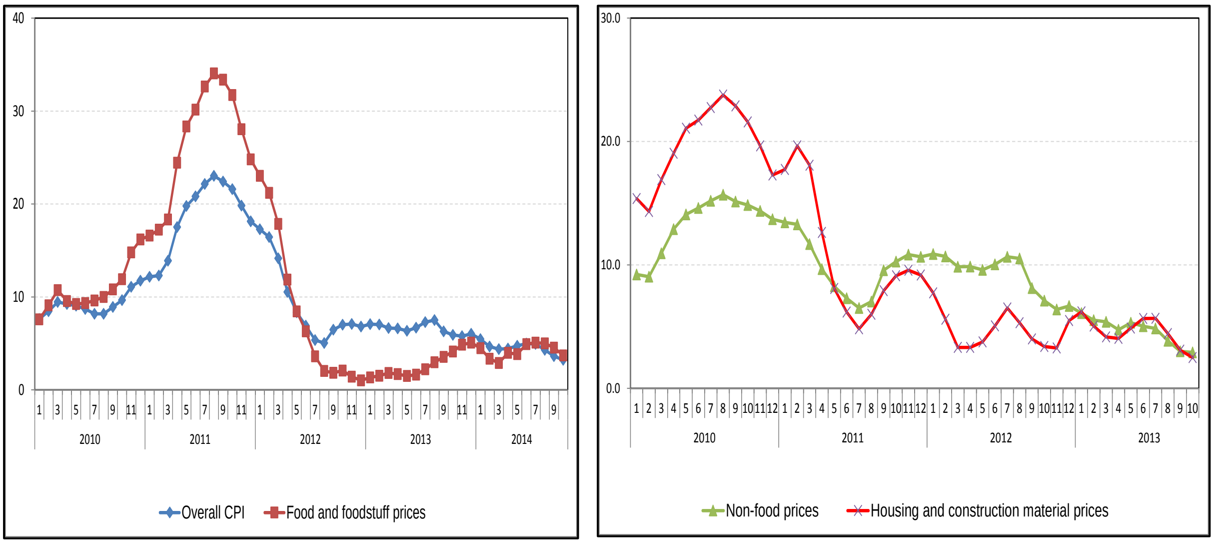


16. Business enterprises still encountered difficulties. In the first ten months of 2014, more than 54.3 thousand enterprises were dissolved or became temporarily inactive (increase of 9.3%[4]), 60 thousand enterprises were newly registered (decline of 6.5%); 213 thousand enterprises reported losses and contributed no corporate income tax. The number of labor in newly established enterprises fell by 0.2%. The number of enterprises resuming operations rose by 10.7%. The number and total capital of newly registered enterprises in Q3 dropped by 16.3% and 32.7%, respectively, compared with Q2.[5] Most of the dissolved or temporarily inactive enterprises are small- and medium-sized.

1.2. Inflation

17. CPI increased by only 2.4% during the first ten months of 2014. Inflation generally became more stable, and was lower than in 2012 and 2013. The cumulative increase in CPI remained far below the target for 2014 (7.0%). Price increases were most notable in food and foodstuff, education, and medicines and health services.

Figure 11: Year-on-year inflation, 2011-2014 (%)



Source: GSO. *Note:* Inflation is year-on-year basis.

[3] Average growth in 2007-2013 was 6.6 per annum. Details can be found in Figure 10.
[4] Source: Business Registration Agency.
[5] Source: Business Registration Agency.

18. Q3 inflation was low because of both low "cost-push" and "demand-pull" factors. On the demand side, YoY growth of private consumption only reached 5.1% in the first 9 months of 2014. Total liquidity increased more slowly because of sterilization when buying foreign currencies. Vietnam's export growth decelerated relative to previous quarters.

19. "Cost-push" factors had fewer pressures on inflation. Export and import price indices decreased by 0.4% and 0.2%, respectively, in Q3. The VND/USD exchange rate was quite stable. The retail price of oil and petrol products tended to decrease. Raising minimum wage in some areas sector has, so far, had limited impact on prices. The most significant impact originated from the increases in medical and tuition fees.

1.3. Money and credit

20. The deposit rate[6] on VND (with term of shorter than 6 months) was stable and lower than the ceiling set by the State Bank of Vietnam (SBV, Table 2). The main reasons include: (i) relatively modest liquidity pressures on commercial banks; and (ii) unattractiveness of other investment channels (such as gold, foreign currencies, real estate).

Table 2: Popular deposit interest of commercial banks

Unit: %/year

	Demand	**Term (shorter than 6 months)**	**6-12 months**	**Longer than 12 months**
VND	0.8-1.0	5.0-6.0	6.0-7.5	7.5-8.1
USD	Institution: 0.25 Household: 1.0			

Source: SBV.

21. The lending interest rates in Q3 fell by 0.5 percentage point comparing to Q2. The corresponding decrease was 0.5-1.5 percentage points compared to those at the end of 2013. 4.3% of outstanding credits still incurred interest charges of over 15%.

22. The lending rate decreased slowly, because of: (i) required provision for bad debts and classification of bad debt within the commercial banks themselves; (ii) competition from the Government bond rate; (iii) SBV's prioritization toward decreasing interest rates of old loans, accompanied by little pressure on interest rates of new credit. The recent decrease of lending rate was largely promoted by the SBV through the SOCBs, rather than smaller credit risk.

23. The gap between of short-term lending and deposit rates was largely in the range of 2.5-4.0 percentage points. The gap between USD- and VND-denominated lending rates induced enterprises to borrow USD and then convert into VND. This tendency was also promoted by the encouragement of foreign-currency loans.

[6] All interest rates are annualized, unless otherwise specified.

Table 3: Popular lending interest rates of commercial banks

Unit: %/year

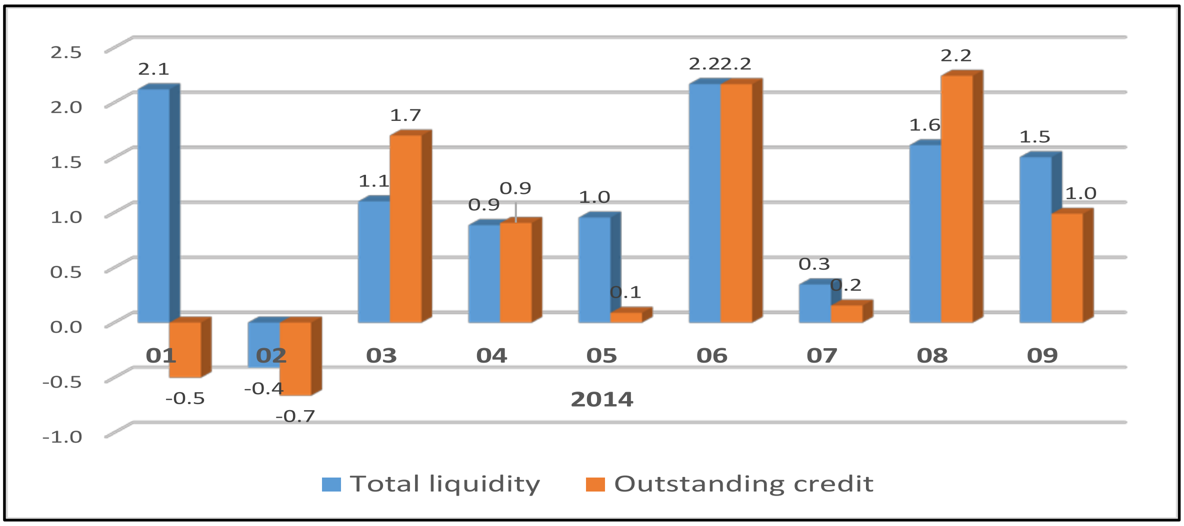
	Target customer	Short-term	Medium and long term
State-owned commercial banks (SOCB)	VND: - Normal business and production	9.0-10.0	10.5-11.5
	- Agriculture; rural development; export; SMEs; supporting industries; high-technology	7.0-8.0	10.0-11.0
	USD:	3.0-4.5	5.5-6.5
Joint-stock commercial banks	VND: - Normal business and production	9.5-10.0	11.0-12.0
	- Agriculture; rural development; export; SMEs; supporting industries; high-technology	8.0	10.0-12.0
	USD:	4.5-6.0	6.0-7.0

Source: SBV.

24. Total liquidity (M2) rose by 3.5% in Q3, which was higher than in the corresponding quarter of 2013 (2.8%). The increase of M2 in the first 9 months of 2014 was mainly due to VND-denominated deposits (rising by 12.4%). Foreign currency deposits increased by only 2.8% from that of the end of 2013. Liquidity and stability of the commercial banks was generally maintained.

25. Credit outstanding grew more rapidly in Q3, particularly at the end of August and September. By August 26, cumulative growth of credit attained 4.5%. The figures by August 29 and September 30 were 6.21% and 7.26%, respectively, possibly due to disbursement of big projects. At the end of September, the outstanding credit for real estate increased by 12.0%, partly helping finance investment, acquisition of projects and construction activities. Outstanding credit for agriculture went up by 6.9% in the first 9 months of 2014.

Figure 12: Monthly growth rate of M2 and outstanding credit (%)



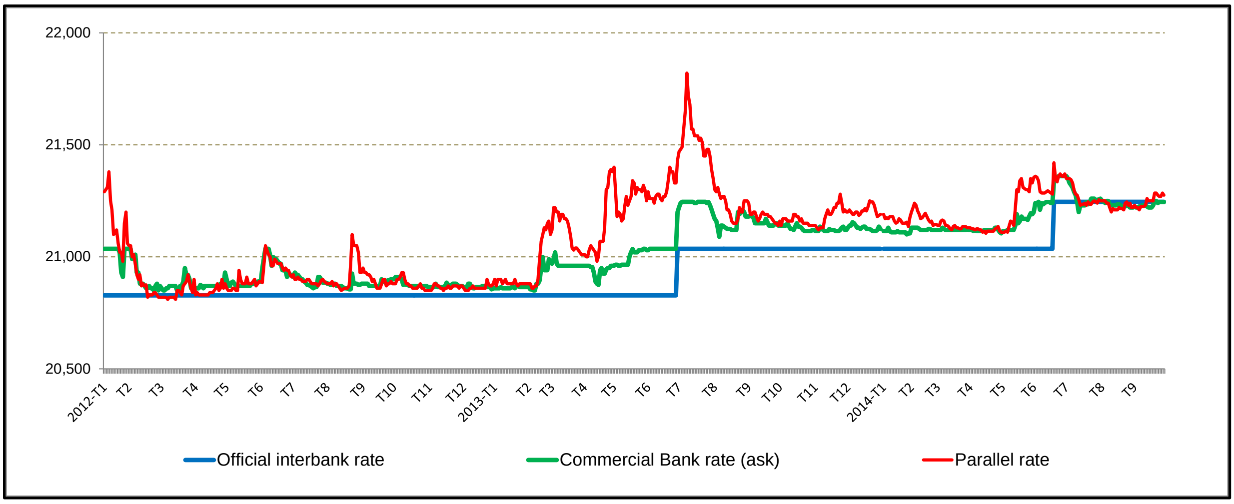
Source: Compilation from various sources.

26. Foreign currency loans increased by 10.9% in the first 7 months of the year; loans in VND rose by 1.9%. The ratio of loans over deposits of foreign currencies attained 93.6% by the end of July (higher than that of 84.3% in late 2013).

27. Extending credits still faced major challenges, namely: (i) poor sales, lack of collaterals and pessimism over economic outlook of firms; (ii) debt restructuring and imbalances between loans-deposits in foreign currencies at banks; (iii) lacks of market-based instruments to reduce lending rates; (iv) crowding-out effects of Government bond issuance.

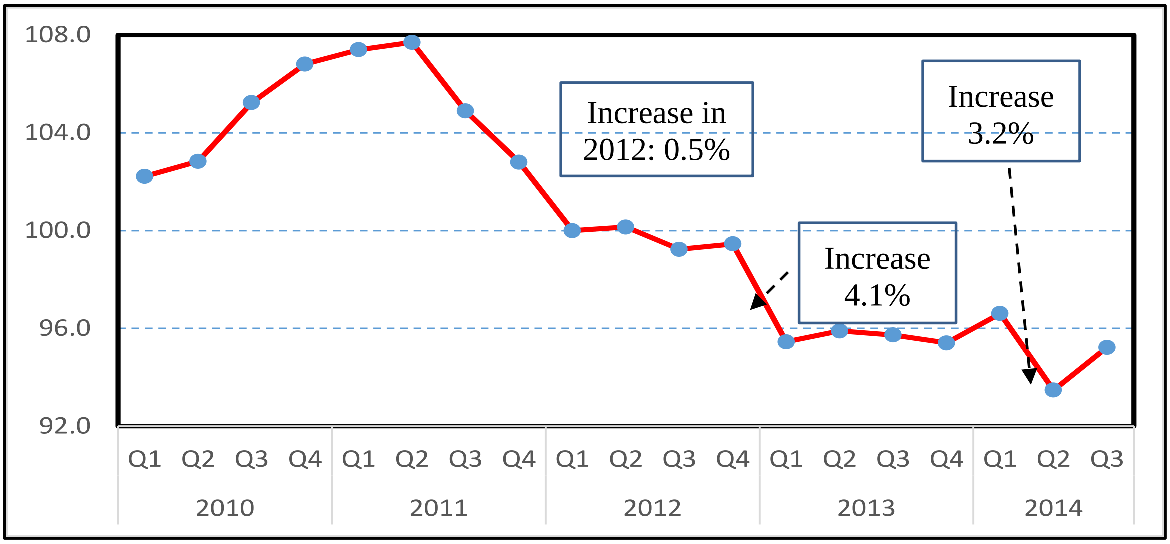
28. The VND/USD exchange rate, both at commercial banks and in parallel market, tended to decrease since mid-July. The exchange rate became more stable since August. Underlying these variations were: (i) SBV's intervention to raise the bid rate of USD; and (ii) purchase of USD by commercial banks to reduce or close their positions.

Figure 13: Movements of VND/USD exchange rate, 2012-9/2014



Source: VNDirect.

Figure 14: Movements of REER



Source: Authors' calculation.

Note: REER is calculated on trade data with 19 leading partners, using CPI-based inflation; Data for the 3rd quarter/2014 are estimated; higher value of REER mean that Vietnamese goods are relatively cheaper than foreign goods; Quarter I/2012=100.

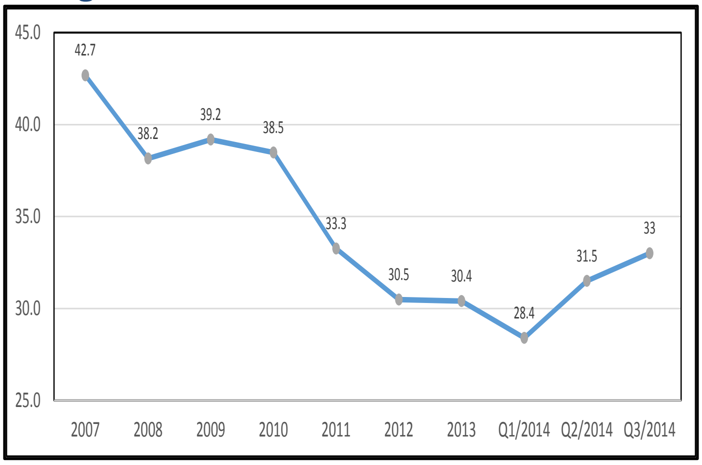
29. The real effective exchange rate (REER) appreciated in Q3, implying that Vietnamese goods became cheaper relative to foreign ones. A higher bid rate for USD supported exports, but the impact was minor due to the nominal appreciation of the USD against other major currencies (Figure 3).

30. The domestic gold market exhibited few fluctuations in terms of supply and demand. The number of transactions fell because commercial banks had fully closed positions of gold deposits, whilst reducing loans of gold. The gap between domestic and (converted) international price remained sizeable with insignificant change, at approximately VND 4 million/tael. International gold price dropped sharply in Q3 (Figure 1), leaving no upward pressure on domestic price.

1.4. Investment

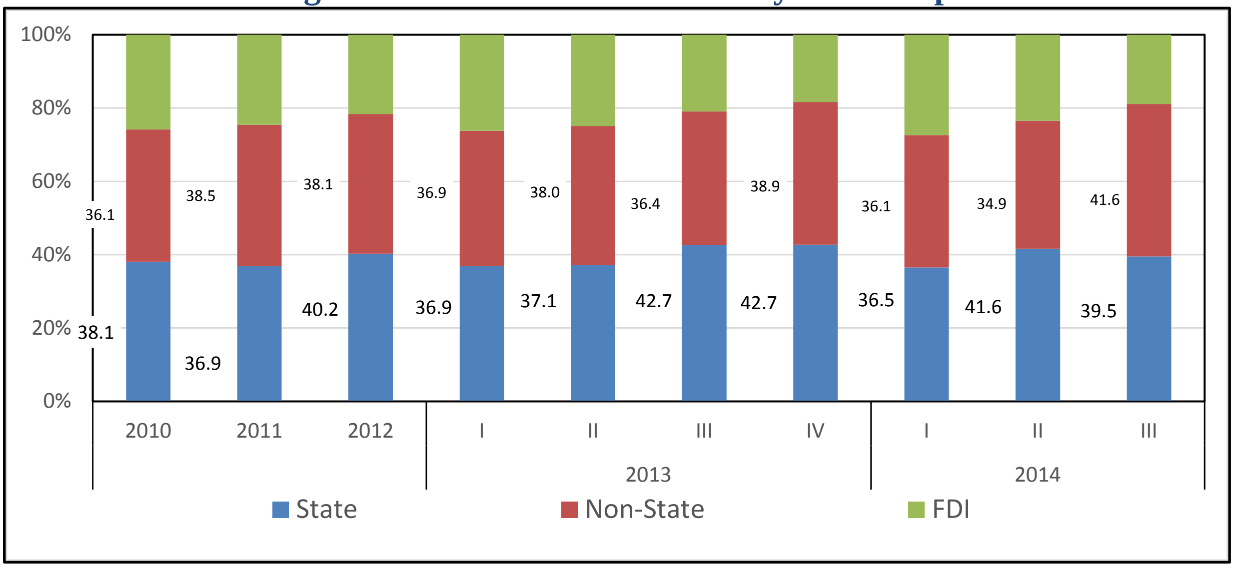
31. The ratio of investment over GDP in Q3 was higher than during the first half of 2014. However, the ratio fell from previous years (Figure 13). Disbursement of investment from the State budget exceeded VND 19.0 trillion per month in Q3, i.e. larger than the first half of the year (VND 15 trillion per month). The shares of state and domestic private investment increased.

Figure 15: Ratio of investment over GDP



Source: Ministry of Planning and Investment.

Figure 16: Investment structure by ownership



Source: GSO.

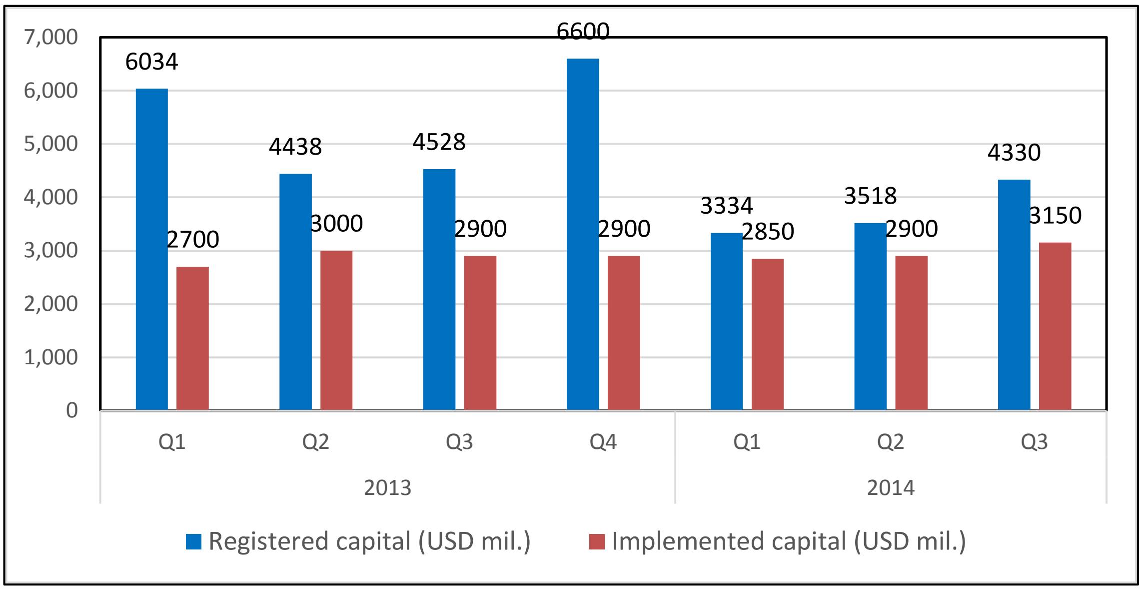
32. Public investment remained one of the main drivers of economic growth. Nonetheless, public investment resources became scarcer. A (significant) portion of

resources from the state budget and Government bonds, since early 2014[7], were used for servicing, repaying or rolling over previous debts. Absorptive capacity of Government bonds slowly improved, as indicated by prevailing problems in preparing project documents, disbursement as well as overall project progress. By the end of July, undisbursed funds at the State Treasury amounted to VND 90 trillion.

33. Registered capital of FDI projects reached USD 4.3 billion in Q3, and USD 2.5 billion in October. This was a slight increase compared to previous quarters. Implemented capital reached USD 3.2 billion and USD 1.3 billion in Q3 and October respectively, i.e. equivalent to the first two quarters of 2014.

34. Investment from Japan increased slowly: registered capital reached just over USD 1 billion since early 2014. Cooperation between Vietnam and Japan under the Industrialization Strategy and related Action Plans need more time for detailed actions and implementation. This cooperation is yet to induce large inflows of FDI from Japan.

Figure 17: Registered and implemented capital of FDI



Source: Ministry of Planning and Investment.

35. FDI in the real estate sector resumed, with over USD 1.2 billion of registered capital in the first 9 months of 2014. Credit outstanding for real estate increased rapidly (by 12.0% since early 2014), indicating that FDI in the sector might rely largely on domestic credit.

1.5. Trade

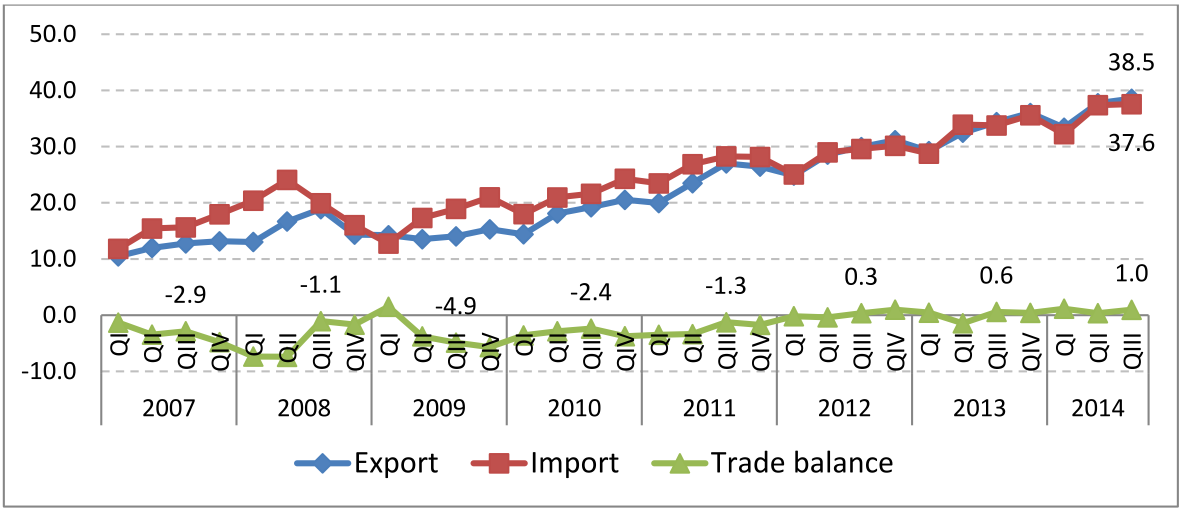
36. In the first 10 months of 2014, exports and imports reached USD 123.1 billion and USD 121.2 billion, respectively. Corresponding YoY growth rates were 13.4% and 11.2%. Both exports and imports grew more slowly this Q3 (compared with the first half of 2014 and Q3 2013).[8]

[7] By September 25, the value of issued Government bonds reached VND 210.2 trillion, equivalent to 90.6% of the planned figure for 2014.

[8] Growth rates of exports and imports in the first 10 months of 2013 were 15.2% and 17.6%, respectively.

37. Export growth could be largely attributed to increased export volume, with respective YoY growth rates of 10.4% in Q3 and 12.8% in the first 9 months. Major export products included crude oil, mobile phones and spare parts, textiles and garment, shoes, fishery, machinery and equipment, etc. The major markets are the USA, EU, and ASEAN, which altogether accounted for nearly 50% of Vietnam's exports.

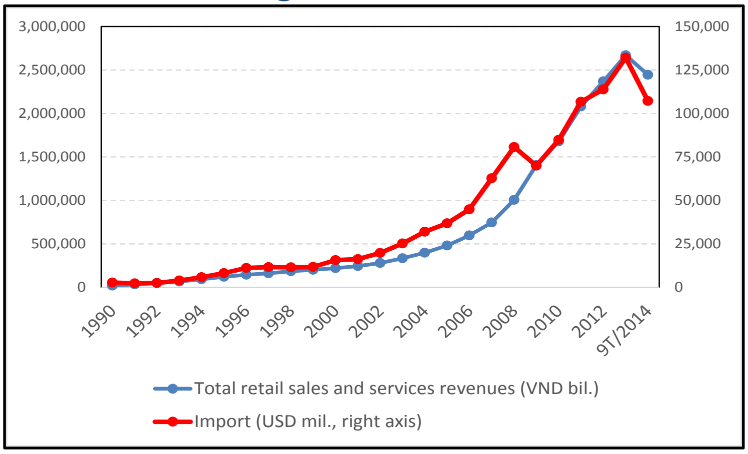
Figure 18: Exports, imports and trade balance, 2011-2014 (billion USD)



Source: General Department of Customs.

38. Import value was highly correlated with total retail sales of goods and service revenues. Materials and machinery, equipment for production altogether accounted for 78.5% of imports in the first 10 months of 2014. Vietnam imported mostly from China (29.0%), ASEAN (15.9%) and South Korea (14.6%).

Figure 18: Correlation between import and total retail sales of goods and service revenues



Source: GSO.

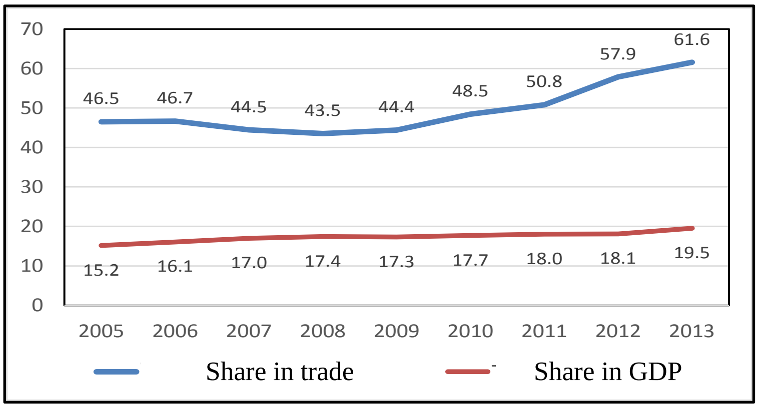
39. FDI enterprises still made up the lion's share shares in exports and imports (of 67.0% and 56.6%, respectively, in the first 10 months). The FDI sector earned a trade surplus of USD 4.2 billion in Q3 and USD 13.8 billion in the first 10 months.[9] If excluding crude oil, the corresponding surpluses were USD 2.5 billion and USD 6.9 billion, respectively. These surpluses were mostly contributed by FDI projects in producing mobile phones and spare parts. [10]

[9] This reflected a change from the situation before 2011. Until 2010, FDI sector always had trade deficit (if excluding crude oil). For further details, see Truong Dinh Tuyen et al. (2011).

[10] Trade surplus of FDI firms in this sector amounted to over USD 12 billion in the first 9 months of 2014 (General Department of Customs).

40. The FDI sector depends heavily on imported materials for export-oriented production. Vietnamese enterprises were yet to be deeply involved in the supply chains led by FDI enterprises. Contribution of FDI enterprises to GDP was thus very small compared with their trade value.

Figure 19: Contribution of FDI sector on trade and GDP



Source: GSO.

41. Trade balance in goods has accumulated to USD 2.5 billion by the end of September, and USD 1.9 billion by the end of October. Trade surplus in goods was mostly attributed to slow growth of gross demand (investment and consumption). Exchange rate policy and increase REER also caused the slowdown in import value in the quarter.

1.6. Budget revenues and expenditures

42. Budget revenues were higher than targeted: during the first 9 months, budget revenues were equal to 81.3% of the target for 2014 and 23.8% of GDP. Of which, domestic revenues and revenues from oil accounted for 67.3% and 12.5%, respectively. Budget revenues in Q3 were higher than in Q1 and Q2 (altogether accounting for 52.8% of the target).

43. Keeping the above pace, budget revenues for 2014 will exceed the annual target. This raises a concern about harmonizing the benefits from increasing current budget revenues (and thus resources for budget expenditure and public investment) and the liquidity and incentives for firms. The discretion in collecting budget revenues causes uncertainty of related revenue items, which in turn undermined the flexibility of firms in implementing investment and business plans.

44. Budget expenditures were closely in line with the schedule: the amount in the first 9 months were equivalent to 75.8% of the target for 2014 and 26.9% of GDP. Of which, development investment accounted for only 17.8%, since current expenditures were sizeable. Debt services (including both interest and repayment of principal) amounted to VND 101 trillion (equal to 3.8% of GDP).

45. The ratio of budget expenditures over GDP went down steadily. The major sources for extending public investment since early 2014 included Government bonds and SOEs. Compared with investment from the State budget, investment from Government bonds and SOEs generally has more flexibility, while less information is provided.

Table 4: Budget revenues and expenditures, 2007-2014

Unit: % GDP

	2007	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*		
								I	*II*	*III*
Budget revenues	**25.3**	**26.6**	**25.1**	**27.3**	**26.0**	**22.7**	**22.9**	**25.8**	**24.0**	**22.1**
Domestic revenues	14.0	14.9	15.5	17.5	16.0	14.7	15.7	17.7	16.1	14.7
Revenues from oil	6.2	5.5	3.4	3.2	4.0	4.3	3.4	3.4	3.1	2.5
Revenues from trade	4.8	5.7	5.8	6.0	5.6	3.3	3.6	4.6	4.7	4.8
Grants	0.3	0.6	0.4	0.5	0.4	0.3	0.2	0.1	0.1	0.2
Budget expenditures	**32.0**	**28.0**	**31.0**	**30.1**	**28.3**	**28.2**	**26.8**	**28.8**	**26.9**	**25.4**
Development investment	9.0	7.4	10.0	8.5	7.5	8.3	6.1	4.4	4.9	5.0
Budget deficit	**5.7**	**4.6**	**6.9**	**5.5**	**4.9**	**5.4**	**5.5**	**4.9**	**4.6**	**5.3**
Budget deficit (excluding principal repayment)	1.8	1.8	3.7	2.4	2.1	3.4	3.9	3.0	2.9	3.3

Source: Calculation from data of the Ministry of Finance.

Note: Data for 2007-2012 are final ones. Data for 2013 are the second estimates.

46. The room for extending investment from Government bonds has been narrowed significantly. Planned values of Government bonds in 2012-2014 to roll over debt amount to VND 137 trillion; the figure for 2014 alone is VND 77 trillion. In 2015, the Government may need VND 130 trillion for rolling over previously issued bonds. Such a value is nearly equal to that for the period of 2012-2014. Some new debt obligation for the State budget also constrained investment from Government bonds. [11] The public debt ratio (excluding SOEs' debt) may reach 64% by 2015, i.e. close to the permitted ceiling.

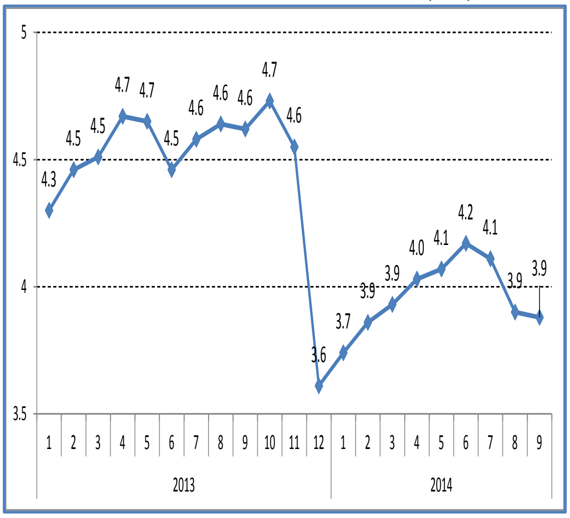
1.7. Bad debt

47. According to the SBV, bad debt ratio of the banking system increased from 4.0% in April to 4.2% in June and then went down to 3.9% in September. By the end of September, approximately 53.6% of bad debts were resolved by means of collection, auction of collaterals, sales, restructuring and use of risk provision.

[11] Some items include: (i) nearly VND 21.1 trillion of debt obligation for the Social Insurance Fund, which the state budget had to pay for those who started to work before 1995 but retired after 1995; (ii) VND 13.8 trillion of value added tax refund; and (iii) VND 12.0 trillion for interest rate subsidy and management fees for Vietnam Development Bank and Vietnam Bank for Social Policies (VnEconomy).

48. Many organizations and experts asserted that the above published ratio underestimated the actual level of bad debt. In late 2013, Moody's estimated the ratio to be at least 15%. The SBV also had some calculations that estimated the ratio at 9%. The officially published ratio decreased substantially in 2013-2014. This raises a question of technical adjustment of data before classifying loans. Delay in implementing the Circular No. 14/2014/TT-NHNN[12] on classifying loans may imply complications with the bad debt situation. Meanwhile, disaggregated data on bad debt (such as term structure, ownership structure, and currency structure) remained absent.

Figure 20: Bad debt ratio released by the SBV, 2013-9/2014 (%)



Source: SBV.

49. The bad debt issue is still complex in several dimensions. *First*, cross ownership among banks, and between commercial banks and business affects the estimation of bad debt. *Second*, the relationship between debtors and commercial banks at times may not be purely commercial. The structure of the bank (being part of a business group and/or sharing State owner with the SOEs) may lead to excessive and/or imprudent credit provision. Some SOCBs extended credits to certain State business groups that exceeded the limit set out in the Law on Credit Institutions in 2010. *Third*, the bad debt issue may overlap with public debt. In fact, a significant amount of sub-prime debts originated from the SOEs. Outstanding debts in development investment projects also led to contractors' bad debt. *Fourth*, Vietnam is yet to fully adopt international accounting standards, so bad debt classification may not help identify bad debts. This in turn weakens confidence on the capacity and willingness to deal with this issue. *Fifth*, auctioning collaterals is a long and costly process. It is further hindered by regulations related to property rights. *Finally*, bad debt of enterprises partly originated from the lack of clarity and determination in management approach (eg. "enterprises could only carry out activities permitted by the authorities" or "enterprises could do all activities not prohibited by the laws"), and frequent changes of regulations.

50. Some factors undermine the efforts to address bad debt. *First*, information on the current situation of, and necessary mechanism to deal with, cross ownership remain absent. *Second*, reducing bad debts is carried out at the same time with the restructuring of SOEs and SOCBs, which widens the scope - even unpredictability - of impacts. Information asymmetry presents a problem for debt buyers if some weak banks are still allowed to reduce bad debts by themselves. *Third*, promotion of economic growth relied heavily on expansion of resources (including capital), without

[12] Circular No.14/2014/TT – NHNN dated May 20, 2014 on revising the regulations on classifying loans and making provisions for risks in order to address credit risks in accordance with Decision No. 493/2005/QD-NHNN dated April 22, 2005.

sufficiently improving absorptive capacity of the economy and credit quality. *Fourth*, slow progress in reducing bad debt is also attributed to concerns about potential responsibility of the decision makers, especially with regard to the price of bad debts or the participation of foreign entities. *Fifth*, insufficient resources and/or mechanisms for reselling bad debts are other constraints. The market for bad debts is underdeveloped, lacking transparency and credible and enforceable institutions. Mechanism to resell bad debts remains at the early stage, thereby failing to mobilize resources for resolving bad debts. Lack of detailed and transparent information on current bad debt situation prevents the participation of the private sector (including foreign entities) in resolving such debts. Using State budget resources is only the last resort, and should not be considered at this stage of identifying and reducing bad debts. *Finally*, the equality and seriousness in purchasing bad debts remains questionable. VAMC (with many members in the management board from SOCBs) arguably put more efforts/resources in buying bad debts of the SOCBs. Adverse selection became more apparent as VAMC ignored toxic debts and only focused on buying other categories of debts.

2. Macroeconomic outlook

51. The forecasts rest on several assumptions regarding Q4 of 2014. World GDP is assumed to increase by 3.1% (YoY).[13] YoY inflation in the US reaches 2.4%.[14] Price of agricultural exports decreases by 0.5% in the quarter.[15] International price of crude oil drops by 5% (YoY). In Vietnam, nominal exchange rate remains stable, while total liquidity increases by about 8% in the quarter. The population goes up by 0.3%, and employment is up by 0.8% in the quarter. The volume of exported crude oil rises by 5% (YoY). REER is assumed to be constant. Via balance of payment, net government transfers increase by 10% (YoY), and (net) private transfers go down by 10% (YoY). Implemented capital of FDI sector is 7% higher than the average level of the first 3 quarters of 2014. Outstanding credit grows by 14% in 2014 as a whole. Public investment will receive VND 70 trillion from the government bonds, assuming that such amount will be fully disbursed in Q4. Reforms of regulatory framework and business – investment environment in Q3 (including simplifying administrative procedures) are assumed to take effect, while a number of important agreements such as TPP, EVFTA, Vietnam-Korea FTA (VKFTA), etc. will be concluded in principle.

Table 5: Projection of macroeconomic indicators for 4th quarter and 2014 (%)

Indicator	*Quarter IV*	*2014*
GDP growth	6.52	5.90
Inflation	4.61	4.61
Export growth	15.72	13.77
Trade balance *(USD bill.)*	-1.5	1.0

Source: Authors' estimations.

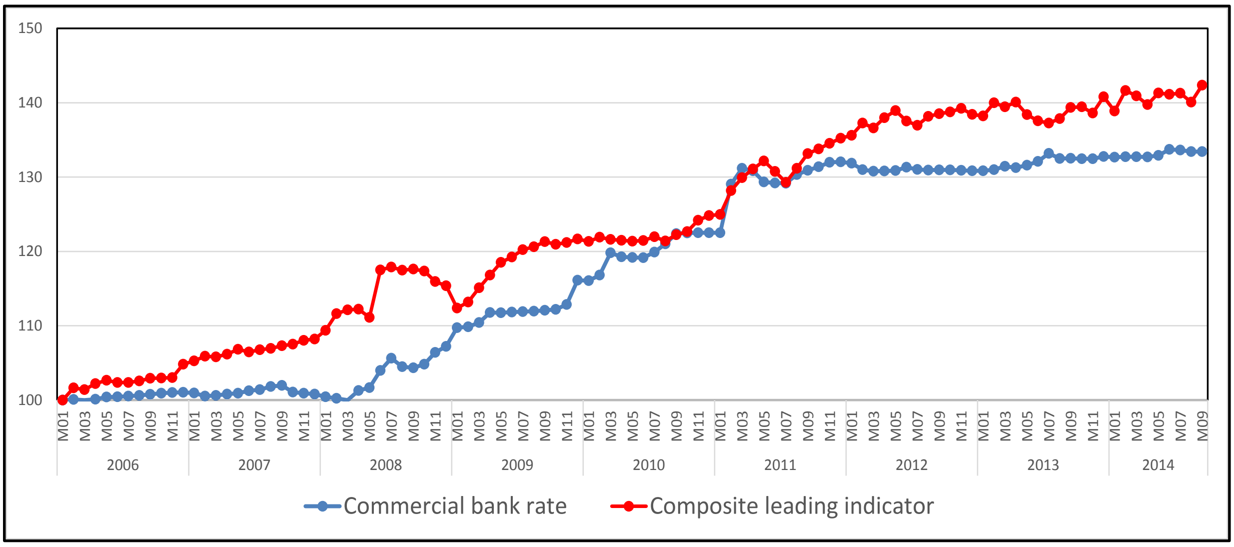
Note: All growth figures are on YoY basis.

[13] Forecast of the IMF (10/2014).
[14] Forecast of the IMF (10/2014).
[15] Forecast of the World Bank.

52. Inflation is forecast to be rather low compared with the target for 2014 (7.0%). The overall trade balance of 2014 is in surplus, albeit lower than the cumulative figure for the first three quarters. Export growth is expected to accelerate marginally in Q4. Overall GDP growth for 2014 is projected at 5.9%. However, these outlooks are conditional upon comprehensive reforms of the business environment contributing to investment expansion.

53. The exchange rate leading indicator showed no major change (over 3%) in recent months. As such, commercial banking exchange rates are expected to be stable in the next 6 months (with the probability of 91.0%). As international prices continue to decrease, REER movement will continue to support Vietnam's export, unless there are significant shocks and/or high inflation.

Figure 21: Leading indicator of exchange rate



Source: Authors' analysis.

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* *

54. In general, the macroeconomic situation exhibited insignificant improvement in Q3. Economic growth accelerated relative to the first two quarters. Export growth and trade surplus were favourable to economic growth, but the contribution of domestic enterprises remained modest. Investment expansion became more apparent, while domestic private sector still encountered many difficulties related to credit access, bad debts and high lending rate. Inflation rate is at the record low level after several years. Exchange rate and prices of essential products were generally stable. Targets of economic growth and inflation for 2014 are likely to be realized, but question remain regarding the quality and sustainability of economic growth. Restructuring the economy, especially SOEs, still faced several obstacles.

III. POLICY ADJUSTMENTS AND RECOMMENDATIONS

1. Important policy adjustments in Q3

55. The policy stance focused on promoting growth recovery through reasonable relaxation of monetary and fiscal measures, simplifying administrative procedures, reducing costs, facilitating business and production activities. The policy focus was on economic restructuring, reforms, growth recovery, and economic integration.

56. Attempts to loosen fiscal policy were more ambiguous. Monetary policy was used to address many tasks to support the restructuring process. Thus, inflation and macroeconomic instability could not be addressed fundamentally. The room for loosening fiscal and monetary policy has narrowed. Structural reforms and improvement of supply-side factors remained slow.

1.1. Policies to support business and production

57. Some regulations on tax, customs, electricity supply, etc. were issued, including simplifying procedures and reducing time to pay taxes,[16] simplifying customs procedures. Interest rates of State credit for investment and export were lowered.[17] The fishery sector received additional support related to credit access for shipbuilding, preferential tax treatment, insurance for offshore fishing, special refinance for banks upon freezing certain debts, etc.[18]

58. Administrative intervention on interest rate of State credit may create distortions in the credit market, undermining the effectiveness of monetary policy. Meanwhile, inadequate supervision capacity may not help induce efficiency of capital.

1.2. Monetary policy

59. As inflation eased rapidly, loosening monetary policy became more obvious through some measures to promote credit.

60. Ceilings on deposit rates were kept unchanged.[19] Lending rate decreased slightly, mainly at the SOCBs. Reducing interest rate of existing loans progressed slowly. Few actions helped narrow the gap between VND- and USD-denominated rates.

61. The interbank VND/USD exchange rate remained at 21,246. To support exports, the SBV actively raised the bid rate of USD and actively communicated the stance of exchange rate management to the market.

62. Credit packages for prioritized sectors (such as fishery, housing for low-income people, etc.) were promoted, but participation was limited. The SBV also encouraged fiduciary loans and foreign currency loans. Some technical interventions were made

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[16] Resolution No. 63/NQ-CP dated 25 August 2014 on some tax measures to reduce difficulties and obstacles for enterprises and promote enterprise development.

[17] Circular No. 108/TT-BTC dated 11 August 2014, replacing Circular No. 77/2013/TT-BTC; Circular No. 126/2013/TT-BTC; Circular No. 161/2013/TT-BTC.

[18] Decree No. 67/2014/ND-CP dated 17 July 2014 on some orientations and measures to develop the fishery sector (in effect on 25 August 2014) and Circular No. 22/2014/TT-NHNN dated 15 August 2014 (in effect on 25 August 2014).

[19] Ceiling on VND-deposit rate stayed at 6% per annum for deposits with term shorter than 6 months, and at 1% per annum for those with term shorter than 1 month. Ceiling on USD-deposit rate was 1% per annum. Refinance rate was kept at 6.4% per annum, while discount rate was 4.5% per annum.

to assist commercial banks in gradually publicizing and/or cleaning their balance sheets.

63. The liquidity of the commercial banking system was managed to help implement such tasks as restructuring the system, reducing bad debt, issuing Government bonds, sterilization upon purchase of foreign currencies, etc. As credit growth was rather slow, the SBV did not adjust the reserve requirement ratio. Restructuring the commercial banks progressed slowly as weak commercial banks were allowed to settle credit problems by themselves.[20]

64. Progress in reducing bad debts was slow[21], due to the shortage of necessary resources and mechanisms to fully function the market for such debts.[22]

1.3. Fiscal policy

65. The Law on Public Investment includes new regulations on the criteria used to classify public investment projects, medium-term investment plan, and adjustments of decentralization in making decisions related to Group-A projects, etc. However, no measure is stipulated to harmonize increases of development investment and current expenditure. Regulations on appraising, coordinating and supervising public investment projects exhibit insignificant changes compared with the existing framework. This affects the independence, quality and consistency of evaluation and appraisal of public investment projects.

66. The State Treasury announced in Q3 a plan to issue Government bonds valued at about VND 50 trillion, of which 3-year and 5-year bonds accounted for 64%. The Government also informed the public of the plan to issue international bonds to roll over debts. Nearly VND 7.6 trillion of the Government bonds for 2015 were advanced for some projects, raising concerns that Government bonds issued in 2014 were largely for rolling over debts.

1.4. Trade policy

Simplification and modernization of customs procedures

67. Reforms of tax and customs procedures were widely implemented, aiming at reducing time for tax declaration and increasing the number of enterprises using e-tax declaration and e-tax payment.[23]

68. The pilot project on Implementing ASEAN Single Window and National Single Window (NSW) has been expanded. Three procedures under the authority of the Ministry of Transport will be connected with the NSW[24]; issuance of certificates of origin and Vietnam Chamber of Commerce and Industry may tentatively be incorporated in the NSW.

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[20] At the time some top leaders of Vietnam Construction Bank (VNCB) were arrested, communication efforts of the SBV and assistance of some other commercial banks helped stabilize operations of VNCB.

[21] By October, VAMC had bought 6,300 debt items, with total original values of more than VND 95 trillion, total bid values of VND 78 trillion; VAMC had bought, reclaimed, and sold some collaterals for VND 3,500 billion.

[22] Only the Circular No. 18/2014/TT-BTP dated 8 September 2014 guiding bidding operations of bad debts and guaranteed assets of VAMC was promulgated.

[23] Circular No. 119/2014/TT-BTC; Circular No. 123/2014/TT-BTC; Decision No. 2544/QD-TCHQ; Decree No. 91/2014/ND-CP.

[24] Including procedures on departure, arrival and transit of sea vessels.

69. The Ministry of Finance proposed to extend the Pilot project on Implementing NSW till June 2016 instead of the expected completion in the end of 2014. The benefits for export – import enterprises from simplified procedures will therefore be delayed.

International economic integration

70. Negotiations of EVFTA and related technical issues are expected to be completed at the end of 2014. The two parties agreed to accelerate negotiations on all issues, especially trade in goods and services, investment, rules of origin (ROO), sanitary and phytosanitary measures (SPS), trade remedies, intellectual property rights (IPR), and government procurement, etc.

71. The TPP negotiation achieved significant results on SOEs, IPR, ROO, labour standards, etc. Nonetheless, consensus is still required on important issues such as market access for goods, cross-border supply of services, financial services, e-commerce, and investment, etc. Vietnam continued to promote negotiations on other issues, namely textiles and garment, leather and footwear, aquatic products, especially in terms of ROO.

72. The VKFTA may be concluded and signed at the end of 2014. The two parties reached agreement on such issues as tariff, ROO, services, investment, regulatory cooperation, trade remedies, SPS, TBT, etc.

73. At the end of August, Ministers of ASEAN member countries and partners signed 7 documents,[25] whilst emphasizing efforts to realize AEC by 2015.[26] Economic Ministers of RCEP countries agreed to conduct the 6th Round of RCEP negotiation in December 2014 in India, focusing on trade in goods, services, and investment.

1.5. Market and price management

74. Since Q3, petrol price underwent 8 consecutive decreases.[27] The petrol price stabilization fund helped to manage the market price of petrol. Under Decree No. 83/ND-CP dated September, focal traders of petrol and oil are allowed to determine wholesale prices, take responsibility for price stabilization in accordance with existing regulations, and receive State compensation of reasonable costs for their stabilization efforts.

75. Regulations on managing retail electricity tariff are also adjusted.[28] No plan to adjust electricity tariff was submitted and examined in Q3.

76. Milk powder for children under 6 years old is subject to price stabilization. The ceiling on wholesale price was applied to 25 milk powder products; the entities and

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[25] ASEAN – India Trade in Services Agreement and ASEAN – India Investment Agreement; Protocol to Implement the 9th package of commitments under AFAS; Protocol to amend the ASEAN Comprehensive Investment Agreement (ACIA); the 1st Protocol to amend the Agreement on Establishing ASEAN - Australia - New Zealand Free Trade Area (AANZFTA); ASEAN Medical Device Directive (AMDD) and ASEAN Mutual Recognition Agreement (MRA) on accounting and auditing services.

[26] ASEAN had implemented 82.1% of priority measures by 2013 as specified in the 2012 Phnom Penh Agenda to establish the AEC in 2015. Vietnam was among the two countries with most rapid progress, attaining 90%. Source: http://www.sggp.org.vn/aseantg/2014/8/359323/ (accessed on 12/9/2014).

[27] The price of petrol was lowered on 18/7, 28/7, 18/8, 29/8,9/9,19/9, 13/10 and 23/10.

[28] Circular No. 16/2014/TT-BCT dated 29 May 2014 on electricity tariff and Decision No. 4887/QD-BCT dated 30 May 2014 on electricity tariff (replacing Circular No. 19/2013/TT-BCT dated 31 July 2013 on electricity tariff and implementation guidelines). Accordingly, the retail electricity tariff is set at 1,509.85 VND/kWh (excluding VAT).

individuals required to register selling prices at the MOF and have to publish the maximum prices of milk powder products.[29]

1.6. FDI policy

77. Under Vietnam's Industrialization Strategy in cooperation with Japan, 4 action plans to develop targeted industries - namely agricultural machinery; agricultural and fishery processing; electronics; and environment and energy savings - were approved at the beginning of August. The action plan for the shipbuilding industry was issued in October. Meanwhile, the action plan for the automobiles and spare parts under the above Industrialization Strategy is being finalized in line with the promulgated Strategy and Master Plan on developing the automobile industry.

78. The draft Investment Law was finalized to submit to the National Assembly for approval. The list of sectors and industries with preferential investment treatment was identified in consultation and coordination with sectoral plans and strategies.

1.7. Coordination of macroeconomic policies

79. The SBV made the most efforts to fulfill responsibility in coordination, being in charge of designing and/or implementing preferential credit packages; stabilizing exchange rate to promote exports; managing liquidity of commercial banks to help reduce bad debts and issue Government bonds. The volume of issued Government bonds remained high (VND 67.1 trillion from June to mid-September), while VND 22 trillion was added to issuance plan of the State Treasury till the end of 2014. This may increase concerns about crowding-out effect on private investments[30].

2. Policy recommendations

80. The macroeconomic environment has been stabilized and strengthened, with signs of economic growth recovery and improved market confidence. Returning to the trajectory of high and sustainable growth is essential to realize targets of socio-economic development in the longer term, and to avoid the middle income trap. In this process, stimulating aggregate demand is less feasible due to smaller policy space and weak effect of related measures.

81. Policy priority should focus more on improving the business environment, simplifying administrative procedures, reducing costs, liberalizing markets, facilitating business activities, encouraging and improving technological capacity in line with sustainable improvement of productivity. It is high time to encourage and promote entrepreneurship. Accordingly, the enterprises will have more incentives and development opportunities, helping accelerate the restructuring process and enhance the economy's competiveness.

* *Monetary policy:*

82. The policy should target a stable inflation, ranging between 4.0-4.3% in 2014 and 5.2-5.5% in 2015. Loosening monetary policy to take advantage of the room for inflation (compared with annual target) should be strictly avoided.

83. To promote wide access to credit is more meaningful for enterprises, but inflation stabilization should be prioritized and credit should not be promoted at all costs.

[29] Decision No. 1079/QD-TTg dated 20 May 2014.
[30] Reflected in modest growth of outstanding credit.

Foreign currency credit and real estate credit should be strictly appraised and supervised. The SBV should, if needed, actively propose to reduce issuance of Government bonds.

84. To consider removal of ceilings on USD deposit rate and VND lending rate for preferential areas (maybe from Q1 of 2015).

85. Administrative intervention and/or pressures on commercial banks to reduce lending rates should be restricted. The reduction of lending rates should rest on smaller credit risks, and is only effective if bad debts fall substantially.

86. The room for exchange rate fluctuations should be widened, thereby increasing flexibility for monetary policy and strengthening the market-based signal of exchange rate. Increasing the trading band (maybe to 1.5%) should be considered; the increase might be significant, but signals to the market on exchange rate flexibility might be more positive. Pegging VND to a basket of major currencies instead of just the USD should be examined more thoroughly.

87. To develop the information and statistical database system with joint efforts of relevant agencies, especially information and estimations of trade, import content of exports, exchange rate, core inflation, interest rate and credit structures, trade finance, balance of payment, etc.

88. To ensure sufficient information and accountability to the market, especially on objectives of monetary policy, bad debts, and restructuring of weak banks.

89. The SBV should take a more pro-active role in restructuring commercial banks and settling bad debts, instead of relying on own efforts by commercial banks. Higher priority should be assigned to the process rather than the target of credit growth. A fully functioning market for bad debts should be established quickly, in which VAMC plays an essential role. Participation of the private sector, including foreign partners, in dealing with bad debts should be encouraged. Mechanism to reduce bad debts should clearly identify and enforce incentives and responsibilities of relevant individuals.

* *Fiscal policy:*

90. Issuing Government bonds should consider such factors as absorptive capacity of the market, risks of term structure, crowding-out effect on private investment, disbursement of projects as well as impacts on economic growth – inflation.

91. Disciplines of fiscal policy and public investment management should be ensured. Controlling and coordinating public investment projects is an essential requirement till 2015. The medium-term investment plan for 2016-2020 should avoid rapid disbursement of public investment projects in the years of 2016-2017. New projects - even mega projects - are still possible, but only by means of cancelling less effective and/or less essential projects.

92. To reduce State budget revenues in Q4 (compared with Q3) to relax liquidity pressure on enterprises. Higher State budget revenues compared to plan should not be over-emphasized. Enforcement of tax obligations of FDI enterprises should be strengthened.

93. To adjust necessary mechanisms to decrease both current expenditure and development investment; aiming at reducing State budget deficit to about 3-4% of

GDP by 2016. Increasing salary for civil servants and governmental officials, etc. should not be considered for the fiscal year of 2015.

94. To establish and implement feasible, detailed and measurable criteria to evaluate public investment projects, especially those using Government bond capital.

95. To review and address procedure-related issues in disbursing Government bond capital. To terminate projects using government bond capital with slow disbursement and/or progress should be credibly considered and enforced.

96. Information on public debts, especially off-budget items, currency and term structures, should be transparent.

97. To review, supervise and evaluate such items that may increase debt obligations to the State budget.

98. The proposal to use State budget for resolving bad debts should not be considered at this moment.

* *Trade policy*

99. To negotiate and sign important FTAs for quick effect and benefits. To harmonize commitments and relevant technical requirements (especially those related to ROO, agricultural products).

100. To improve awareness of, information to and consultation with enterprises during negotiation and implementation of FTAs, especially TPP, EVFTA, RCEP and AEC.

101. To deepen reforms of tax and customs procedures, etc. to facilitate business activities. To complete the pilot project on NSW in the end of 2014 (rather than extending it till June 2016). To cooperate with partners to sign MRAs. To disseminate information on regulations and technical barriers related to trade, etc.

102. To improve marketing activities about Vietnam and its products; to expand and diversify export markets.

103. To strengthen capacity of competition management, anti-subsidy, trade dispute settlement, market management, legal assistance to enterprises. To examine and participate in some international conventions to simplify relevant procedures and documents for enterprises.

104. To reduce dependence on trade relation with China in line with suitable orientation to deepen relations with other partners. This should be accompanied by investment in supporting industries to attract investment of large corporations, insurance for enterprises to invest in science – technology, and restrictions of Renminbi-financed transactions with China; etc.

* *Price management*

105. Price reform should not only focus on directly amending the price management mechanism of for essential products (such as petrol, electricity, etc.). Instead, transparent and credible efforts should be made to enhance competition and/or product quality in such markets.

* *FDI policy*

106. To encourage FDI projects into some sectors/industries that help solve bottlenecks and weaknesses of the economy, and facilitate investment attraction. These

sectors/industries have the most urgent demand for investment and have relatively high absorptive capacity of capital.

107. To promote and attract investment by multi-national corporations and enterprises in related supporting industries. To promptly guide domestic enterprises to prepare and cooperate with FDI partners.

108. To ensure disciplines in developing and managing plans. To avoid using plans to formalize pre-developed investment ideas. To negotiate with foreign investors to ensure the compliance of projects with sectoral plans, international commitments, national defense and security.

109. To actively select investment partners, focusing on such sectors and products that Vietnam has advantages and intention to develop, whilst making maximal use of partners' capacity and experiences.

110. To consult FDI enterprises substantially on relevant policy adjustments (including increasing minimum wage), thus avoiding being sued under international treaties.

* *Other recommendations*

111. To improve coordination of macroeconomic policies in the aspects of: identifying priorities, roadmap and scope; sharing information and consultation during implementation; and reviewing policy implementation. Dominance of fiscal policy over monetary policy, and assignment of too many (reform, management) objectives to monetary policy should be avoided.

112. It is necessary to improve quality and accountability of data, especially consistency of data on economic growth, production, investment, and trade. Development of indices on business confidence and consumer confidence should be institutionalized.

113. The economic restructuring and shift of growth paradigm need to be revitalized. FTAs represent the necessary external driving forces, but are by no means sufficient. Restructuring SOEs should be accelerated to gather "momentum" and improve confidence for stakeholders, despite major concerns about obstacles and individual responsibilities. The commercial banks should be strengthened for better effectiveness and competitiveness. Restructuring of public investment should be further institutionalized, rather than just relying on the Law on Public Investment. More importantly, the State agencies should encourage participation of the private sector in the restructuring process, not only in implementation but also in the brainstorming and proposal stages. In doing so, harmonizing interest of different groups with national interest is an important prerequisite.

Box 1: Issues for policy debate

1. Are the volume and disbursement of government bonds sufficient? Issuing more government bonds contributes to fiscal condition and public investment capital, but will capacity to repay debts be a serious concern (even if public debt is below the permitted level)? If such resources are instead channeled to the private enterprises, what will be the impacts?

2. Is the preparation of enterprises adequate to implement new FTAs? Enterprises are supposedly willing and would like to be consulted and actively participate since the negotiation stage. In fact, however, enterprises usually do not show up in events to disseminate information on such FTAs. Does the problem lie in the quality of the consultation attempts?

3. Should the SBV continue with administrative measures – a prominent feature since 2011? If not, which measures should be phased out first? Will such measures affect the achievement of macroeconomic objectives and banking reforms in the coming period?

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114. Despite many difficulties, Vietnam economy is expected to recover rapidly in late 2014. Nonetheless, macroeconomic instability since 2008 has not been addressed fundamentally because of several policy switches to prevent an economic downturn. Further promotion of economic growth by means of expanding public investment and credit raises a concern about the re-emergence of previous macroeconomic risks. Therefore, stimulating business – manufacturing activities should be accompanied by fundamental microeconomic reforms, aiming at increasing potential output. The preference for supply-sided reforms should be fully acknowledged and concretized. Still, impediments to such reforms persist. The time till the end of 2015 serves as a critical test for the Government to promptly undertake reforms, ultimately enabling the economy to recover and return to the trajectory of high and more sustainable growth.

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STATISTICAL APPENDIX

	Unit	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*				*2014*		
								I	*II*	*III*	*IV*	*I*	*II*	*III*
GDP growth rate														
Overall GDP growth	%	7.1	5.7	5.4	6.4	6.2	5.2	4.8	5.0	5.5	6.0	5.0	5.4	6.4
Agriculture – forestry and fishery	%	4.0	4.7	1.9	3.3	4.0	2.7	2.2	2.0	3.0	3.3	2.4	3.3	3.1
Industry and construction	%	7.4	4.1	6.0	7.2	6.7	5.7	4.6	5.7	5.2	5.9	4.7	6.1	8.3
Services	%	8.5	7.6	6.5	7.2	6.8	5.9	5.6	6.2	6.8	7.2	5.9	6.1	6.0
GDP structure by economic sector														
Total	%	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	*100.0*	*100.0*	*100.0*
Agriculture – forestry and fishery	%	18.7	20.4	19.2	18.9	20.1	19.7	13.3	22.2	17.3	19.5	12.9	17.7	17.4
Industry and construction	%	38.5	37.1	37.4	38.2	37.9	38.6	40.2	37.5	36.5	39.2	*40.3*	*38.7*	*38.0*
Services	%	42.8	42.5	43.4	42.9	42.0	41.7	46.6	40.3	46.2	41.3	46.8	43.6	44.6
Trade														
Growth rate of exports	%	22.2	30.0	-9.2	26.5	34.2	18.2	17.5	13.6	14.8	15.6	14.3	16.2	12.1
-FDI sector	*%*	*21.7*	*25.4*	*-30.7*	*41.2*	*40.3*	*33.7*	*27.9*	*28.4*	*26.2*	*23.6*	*18.2*	*16.1*	*37.5*
Growth rate of imports	%	37.0	32.2	-13.0	21.3	25.8	6.6	14.8	17.0	14.2	18.0	12.1	10.2	11.2
- FDI sector	*%*	*31.6*	*32.3*	*-8.8*	*41.8*	*32.1*	*22.7*	*26.1*	*25.9*	*25.4*	*19.9*	*14.6*	*7.3*	*8.2*
Exports /GDP	%	62.5	66.1	56.6	63.4	72.6	73.5	89.1	81.4	79.7	65.1	92.8	87.2	81.5
Money														
M2 growth (YoY)	%	46.1	20.3	29.0	33.3	12.1	18.5	3.8	3.4	2.8	7.7	2.8	4.1	3.5
Credit growth rate (YoY)	%	53.9	25.4	39.6	32.4	14.3	8.9	1.2	3.5	2.1	5.3	0.5	3.2	3.4
VND/USD exchange rate of banks (period average)	VND	16,087	16,451	17,803	19,111	20,661	20,851	20,863	20,951	21,124	21,097	21,119	21,183	21,244
VND/USD interbank exchange rate (period average)	VND	16,128	16,309	17,074	18,630	20,532	20,828	20,828	20,831	21,036	21,036	21,036	21,063	21,246
Investment														
Investment/GDP	%	42.7	38.2	39.2	38.5	33.3	30.5	29.6	29.6	33.8	33.2	28.4	31.5	33
Implemented capital, FDI	USD bil.	8.0	11.5	10.0	11.0	11.0	10.0	2.7	3.0	2.9	2.9	2.9	2.9	3.2
Others														
Inflation (YoY)	%	12.6	19.9	6.5	11.8	18.1	6.8	6.6	6.7	6.3	6.0	4.4	5.0	3.6
State budget deficit/GDP	%	5.7	4.6	6.9	5.5	4.9	5.4	5.4	5.0	5.3	4.7	4.9	4.6	5.3
Current Account	USD bil.	-7.0	-10.8	-6.6	-4.3	0.2	9.1	2.4	1.5	3.9	1.7	2.6	2.8	-
Balance of Payment	USD bil.	10.2	0.5	-8.5	-1.8	1.2	11.9	3.0	-3.3	-0.8	1.7	3.0	2.2	-

Source: Compilation from various sources.