INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/240

VIETNAM

July 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR VIETNAM

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with Vietnam, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 17, 2016, consideration of the staff report that concluded the Article IV consultation with Vietnam.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 17, 2016, following discussions that ended on April 22, 2016, with the officials of Vietnam on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 1, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Vietnam.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 16/307
FOR IMMEDIATE RELEASE
June 27, 2016

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with Vietnam

On June 17, the Executive Board of the International Monetary Fund (IMF) concluded the 2016 Article IV consultation[1] with Vietnam.

Vietnam's economy has experienced solid growth with low inflation, reflecting policy attention to maintaining macroeconomic stability. Economic performance was robust through most of 2015, driven by rapid export growth, foreign direct investment (FDI), and strong domestic demand. Manufacturing and exports moderated near year-end—reflecting slowing external demand—and agriculture production fell sharply in the beginning of 2016, owing to a severe drought and arable land salinization. Inflation declined below one percent in 2015 before ticking upward in early 2016 due to higher food and administered prices. The current account narrowed sharply from rising imports, and gross international reserves declined in the second half of 2015 before recovering in early 2016.

Fiscal policy has been loose in recent years. The deficit was 5.9 percent of GDP last year. Revenues rose strongly, reflecting tax and non-tax collection, while expenditure was higher than planned, owing to carry-forward spending by local governments, and higher capital, social and interest spending. Public debt has risen sharply. Monetary policy was accommodative over most of last year amid falling inflation, and credit growth was robust. Liquidity conditions were tightened around year-end as global financial volatility increased, and the exchange-rate regime was made more flexible. A number of important reform steps have been taken, but non-performing loan (NPL) resolution, bank recapitalization, and state-owned enterprise reforms have been sluggish.

For 2016, growth is projected to moderate to around 6 percent, reflecting the adverse agriculture shock, lower external demand and spillovers of tighter global financial conditions. Headline inflation is projected to rise modestly. Reserves are expected to increase to around 2 months of imports, and public debt to reach around 62 percent of GDP. While the near-term outlook is broadly positive, there are downside risks, including from high and rising public debt, slow NPL

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

resolution progress, prolonged drought, tighter or more volatile global financial conditions, and weak growth in key advanced and emerging economies. Upside opportunities exist, including rapid implementation of recently signed trade agreements, which would usher in productivity gains, fuel exports and incentivize reforms.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended Vietnam's recent good macroeconomic performance and the significant progress made in achieving the Millennium Development Goals. Directors were encouraged by the broadly favorable economic outlook, but noted that external and domestic risks exist, mainly from the rising public debt, rapid credit growth, and slow banking sector reforms. Directors welcomed the authorities' commitment to prudent policies and reforms, and emphasized that determined steps are needed to build on the current achievements and boost the economy's growth potential.

Directors underscored that growth-friendly fiscal consolidation is key to reversing the rise in public debt and creating space for critical social and development expenditures. They urged the authorities to begin taking measures this year to reduce the fiscal deficit to 3 percent of GDP by 2020. Directors stressed the importance of structural revenue-enhancing measures, including rationalizing exemptions and incentives, broadening the tax base, and further strengthening revenue administration. They also encouraged the authorities to take steps to reform the civil service to rationalize the public wage bill, improve spending efficiency, and use equitization receipts to finance the deficit.

Directors supported the current monetary policy stance and welcomed the shift to a more flexible exchange rate regime, while encouraging the authorities to remain vigilant should price pressures emerge. They called on the authorities to continue to build international reserves, further strengthen the monetary policy framework, and undertake institutional and operational reforms to support a gradual shift toward using inflation as the nominal anchor.

Noting that the recent rise in credit growth could pose risks to financial stability, Directors welcomed the authorities' proposals to tighten macroprudential policy and recommended further tightening if needed. They stressed the need for further efforts on banking sector reforms, including measures to resolve nonperforming loans, recapitalize banks by existing shareholders, enhance governance, risk management, and supervision, and adopt international financial reporting standards.

Directors encouraged the authorities to intensify the pace of structural reforms to boost productivity and the economy's long-term growth potential. They welcomed progress made on

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

the legal framework for state-owned enterprise reforms and urged continued efforts in this area, including greater transparency and a level-playing field with the private sector. Directors also recommended improvements in education to strengthen human capital and address skills mismatches, complemented by a conducive business climate.

It is expected that the next Article IV consultation with Vietnam will be held on the standard 12-month cycle.

Vietnam: Selected Economic Indicators

Population: 91.7 million | Per capita GDP 2015 (US$): 2,088

Quota (current): SDR 1,153.10 millions/ 100 percent of quota | Poverty rate (as of 2014): 13.5

Main products and exports: electronics, garment, crude oil, rice, coffee, and rubber

Key export markets: United States, Euro Area, Japan, Developing Asia

	2012	2013	2014 Est.	2015 Est.	2016 Proj.
Output					
Real GDP growth (%)	5.2	5.4	6.0	6.7	6.1
Employment					
Unemployment (%)	2.7	2.8	2.1	2.4	2.4
Prices					
Inflation (%, end of period)	6.8	6.0	1.8	0.6	3.5
General government finances					
Revenue and grants (% GDP)	22.6	23.1	21.9	23.7	22.9
Expenditure (% GDP)	29.4	30.5	28.0	29.6	29.5
Net lending (+)/borrowing(-) (% GDP)	-6.8	-7.4	-6.1	-5.9	-6.5
Public debt (% GDP)	47.9	51.8	55.1	58.3	62.1
Money and credit					
Broad money (% change)	18.5	18.8	17.7	16.2	19.7
Credit to the private sector (% change)	8.7	12.7	13.8	18.8	17.4
Nominal short-term lending rate (% less than one year)	12.4	9.7	8.5	...	...
Balance of payments					
Current account (% GDP)	6.0	4.5	5.1	0.5	0.3
FDI (% GDP)	4.6	4.1	4.3	5.6	6.5
Reserves (months imports)	2.2	2.0	2.4	1.9	2.0
External debt (% GDP)	37.4	37.3	38.3	43.1	45.2
Exchange rate					
REER (% change)	4.1	6.8	6.2	3.4	...

Source: Vietnamese authorities and IMF staff estimates.

INTERNATIONAL MONETARY FUND

VIETNAM

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

June 1, 2016

KEY ISSUES

Context. Growth has been robust with low inflation. Sustaining this good performance and addressing key risks will require a second generation of policy upgrades. A new government took office in 2016 with a commitment to reforms that, if implemented, would place Vietnam in a sound position to achieve its ambitious development goals.

Outlook and risks. Growth is projected to moderate this year to around 6 percent with underlying inflation contained and the current account broadly in balance. Key downside risks include the external environment, high public debt now estimated above 60 percent of GDP, and unresolved banking sector nonperforming loans (NPLs). Implementation of new trade agreements is an upside medium-term opportunity.

Fiscal policy. With persistently high deficits, public debt has risen sharply and the risk of debt distress has climbed. A growth-friendly consolidation is needed, beginning this year, to ensure debt sustainability and provide space for critical spending and state-owned bank recapitalization. The focus should be on structural revenue-enhancing measures, rationalizing the public wage bill, and raising the efficiency of capital spending.

Monetary and exchange rate policy. Monetary policy can remain on hold absent underlying inflation pressures. The successful adoption of a more flexible exchange rate regime is commendable. Gradually shifting toward using inflation as the nominal anchor, while allowing exchange rate flexibility to buffer shocks, would enhance stability.

Banking sector reform. Some welcome reforms have been taken, but the approach of allowing banks to recapitalize mainly via retained earnings will take many years and raises macrofinancial risks. Faster NPL resolution is needed, along with recapitalization of banks by existing shareholders, including the budget for state-owned banks. Proposals to tighten macroprudential policy are welcome given overly fast credit growth.

Structural and state-owned enterprise (SOE) reforms. Accelerated SOE and structural reforms are needed to boost productivity. Key elements include more comprehensive SOE equitization with improved transparency and governance, the creation of a level playing field with the private sector, and education reforms to address skills mismatches.

Approved By
Markus Rodlauer and Chris Lane

Discussions took place April 6–22, 2016. The staff team comprised J. Nelmes (Head), J. Schittmann, D. Corvino (all APD), T. Saadi Sedik (MCM), and J. Dunn (Resident Representative).
Ms. Tangcharoenmonkong and Mr. Nguyen (OED) joined the concluding meetings. Ms. Zhuang and Ms. Sirihorachai assisted in this report's preparation.

CONTENTS

APPENDIX

CONTEXT

1. **Vietnam's economy has experienced solid growth with low inflation, reflecting policy attention to maintaining macroeconomic stability**. Excellent progress has been made in achieving Millennium Development Goals and Vietnam's openness to trade and foreign direct investment (FDI) has been an engine for growth of increasingly sophisticated exports to diversified markets. Entrenching these achievements and strengthening resilience in an uncertain and potentially volatile global environment will, however, require important policy upgrades to tackle legacy risks and emerging challenges. Public debt is high, external debt has increased, and rapid credit expansion poses a risk to financial stability while adequate bank recapitalization to deal with impaired assets has yet to materialize. Structural reforms, including for state-owned enterprises, are needed to strengthen the spillover of productivity gains in the foreign-invested sector to the domestic economy.

2. **The January 2016 Party Congress has been accompanied by a renewed reform drive**. A new government was formed in April, three months ahead of the traditional schedule, reflecting the authorities' desire to begin implementing their economic policy reform agenda without delay. In addition to reaffirming the importance of maintaining macroeconomic stability, emphasis has been placed on increasing use of market-based mechanisms for economic reforms. This reenergized push provides an excellent opportunity to tackle key issues in a second generation of reforms that would place Vietnam in a position to take full advantage of its potential and recent trade agreements to become one of Asia's most successful and dynamic economies.[1]

3. **Policies have been broadly in line with past Fund advice, although implementation in some key areas has lagged**. A more flexible mechanism for setting the daily central exchange rate was introduced, monetary policy is increasingly focusing on inflation stability as a key objective, and the authorities are interested in moving toward using inflation as a nominal anchor. Banking sector reforms have been undertaken, including phasing out explicit loan classification forbearance and strengthening supervision. Macroprudential oversight has been strengthened. However, resolution of nonperforming loans (NPLs) and recapitalization has not progressed in earnest. The legal framework for state-owned enterprise (SOE) reforms has been developed but implementation is lagging. Sustained fiscal consolidation has not materialized.

MACROECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

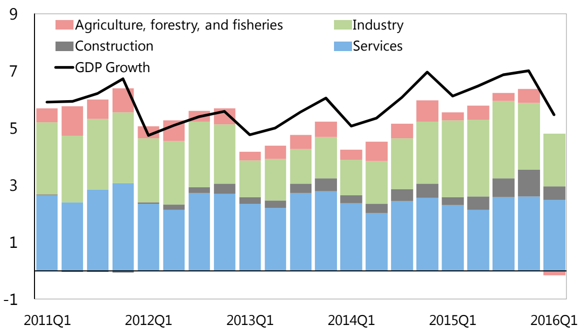
4. **Economic growth was robust last year, but it slowed entering 2016**. Real GDP rose by 6¾ percent (y/y) in 2015, underpinned by supportive macrofinancial policy settings. Both investment and consumption contributed to strong domestic demand. After holding up well

---

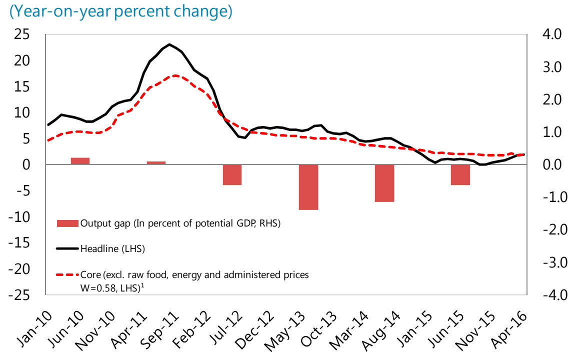
[1] Free trade agreements were concluded in 2015 with the Eurasian Economic Union, Korea, and the European Union. The Trans-Pacific Partnership (TPP) agreement was signed in February 2016.

through the first half of last year export growth began to moderate in the second half, reflecting lower commodity prices and slowing external demand. Import growth, mainly machinery and intermediate goods, was strong in the first three quarters, reflecting a tooling-up of capacity related to recent trade agreements, but it also slowed toward year-end, especially inputs for export processing. Real GDP growth slowed to 5½ percent (y/y) in the first quarter of 2016. Agriculture production fell sharply owing to a severe drought and arable land salinization, and industrial production moderated in line with soft trade.

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



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

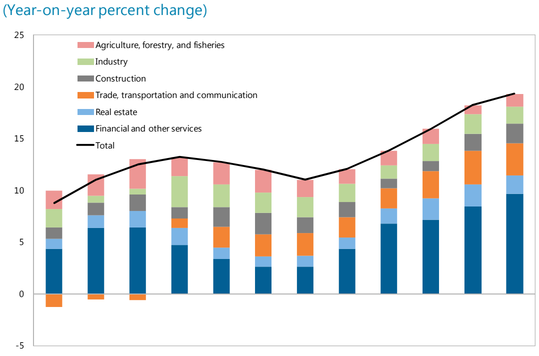


[1] W=2014 Weight

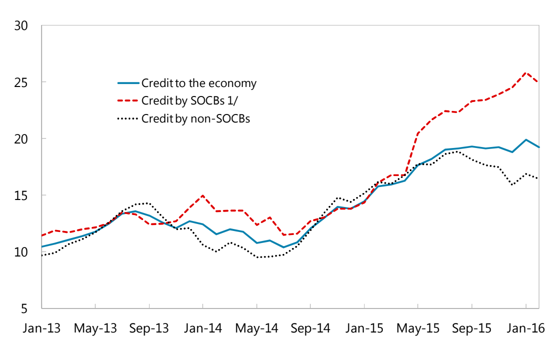
5. Inflation has fallen significantly. Headline inflation fell to below 1 percent (y/y) before ticking upward in early 2016 due to higher food and administered healthcare prices. Core inflation excluding administered price adjustments has fallen to around 1¾ percent (y/y). Lower fuel and import prices, absence of wage pressures, and a small output gap were the main drivers. Real estate prices have increased slightly, but remain below their previous peak, partly owing to a substantial increase in supply, particularly residential apartments, hotels, and retail space.

6. Credit growth picked up to 19¼ percent (y/y) in early 2016, reflecting demand, an easing of macroprudential policy via lower risk weights on lending to the real estate and securities sectors, and higher credit growth targets for the banking sector announced by the State Bank of Vietnam (SBV) (18–20 percent (y/y) for 2016). State-owned banks expanded credit at a significantly faster rate than private banks and most of the increase was to the real estate, financial, and personal sectors including mortgages, raising concerns over the productivity of new credit.

Contribution to Credit Growth
(Year-on-year percent change)



Credit Growth by Type of Credit Institutions
(Year-on-year percentage change)

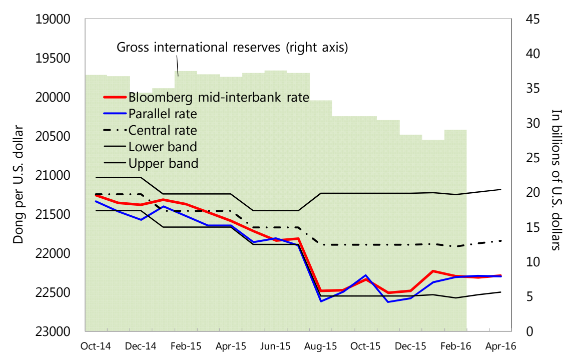


1/ Includes the four main state banks: Vietcombank, Incombank, BARD and BIDV.

7. Heightened global financial volatility spilled over into domestic markets in the second half of 2015, but conditions have improved recently. In response to short-term and portfolio capital outflows and downward pressure on the exchange rate, the SBV made the exchange rate regime more flexible (see text box) and intervened in support of the dong. International reserves declined by an estimated US$9 billion from their 2015 peak to around US$28.3 billion (below 2 months of imports), low by most metrics. In the first months of this year, capital flows reversed with portfolio and direct investment inflows, and international reserves increased to US$29 billion in February. Government bond yields are slightly lower at the short end and up about 25 basis points at the long end compared to a year ago, while EMBIG and CDS spreads have widened around 25 basis points. Equity markets were relatively volatile, but broadly unchanged from a year ago.

Text Box: Exchange Rate Developments

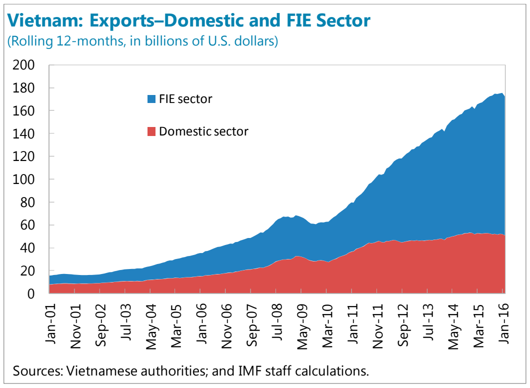
Exchange Rates 1/

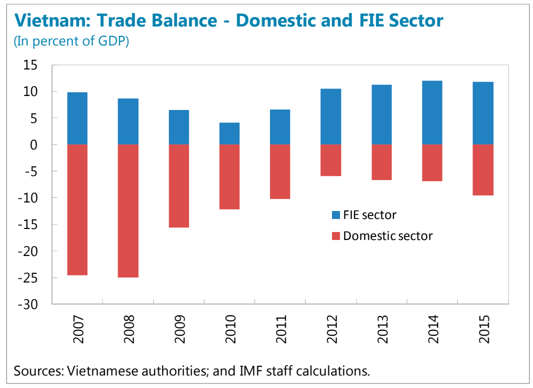


1/ An upward movement indicates an appreciation of the dong.

In the first half of 2015 the central exchange rate fixing against the U.S. dollar was devalued by 2 percent in two separate steps, while the +/-1 percent trading band for the interbank rate around the central rate was retained. In August 2015 the SBV widened the trading band first to +/-2 percent, and then to +/-3 percent while devaluing the central rate by 1 percent. In December, pressures resurfaced when the U.S. Federal Reserve increased interest rates, prompting the authorities subsequently to introduce a more flexible mechanism for setting the daily central exchange rate based on: (i) the previous day's dong/USD exchange rate; (ii) exchange rates of countries that have substantial trade and financial links with Vietnam; and (iii) domestic macroeconomic conditions. The +/-3 percent trading band was retained. By end-2015, the dong had depreciated by about 5 percent against the dollar, but was about 3½ percent appreciated in real effective terms. In the first months of this year, the central rate has appreciated slightly and the interbank exchange rate has appreciated well off the bottom of the trading band.

8. A dual, segmented external current account position continues. The surplus narrowed sharply with rising imports last year and the domestic sector continued to run a trade deficit. However, FDI strengthened, exports of foreign-invested enterprises (FIEs) continued to perform well, and the FIE sector's trade surplus remained. While no clear evidence of exchange rate misalignment exists, the external position should be strengthened through higher reserves and structural and SOE reforms to improve domestic-sector competitiveness that facilitate productivity spillovers from the FIE sector (Boxes 1 and 2).





9. **The near-term outlook is broadly positive, but challenges exist**. Growth is projected to moderate this year to around 6 percent. The softening reflects the drought that has adversely impacted agriculture, lower external demand, and spillovers of tighter global financial conditions. Headline inflation is projected to rise due to higher food and administered prices, although the underlying rate should remain moderate absent broad-based demand pressures. The current account balance is projected to decline slightly in the near term as exports and imports soften. It would improve thereafter as the export sector responds to increased productive capacity and free trade agreements. FDI inflows are projected to remain strong while short-term capital outflows moderate. Over the medium term, growth is projected to settle around its potential rate of 6¼ percent. A bolder policy package of structural, fiscal, and banking reforms would raise productivity, mitigate risks, and facilitate sustained higher long-run growth.

10. **Widening imbalances pose increasing risks to the outlook that, if not addressed, could potentially interact to create macrofinancial spillbacks**.

- *On the domestic side*, the drought's impact on agriculture could be deeper and more sustained. Inadequate fiscal consolidation would further increase public debt and debt distress risk, reduce space for bank and SOE reform costs, and pressure interest rates, which could worsen corporate performance and banks' credit quality, creating spillbacks for sovereign risk. Rising private external debt increases the costs of—and potentially constrains incentives to allow—further exchange rate flexibility. Banking-sector risks remain owing to slow progress in recapitalization and NPL resolution. Sustained rapid credit growth—particularly to sectors that do not raise the economy's growth potential—could fuel future NPLs and increase banking sector risks. Distress in the banking sector could exacerbate public debt distress risk, undermine growth, and cause an abrupt exchange-rate shock.

- *External shocks could trigger domestic risks*. Tighter or more volatile global financial conditions or a sustained surge in the U.S. dollar could re-ignite capital outflows and pressure on the exchange rate, and raise domestic interest rates. International reserves, which are already low, could decline further absent exchange-rate flexibility. Slower global growth or a sharp slowdown in China could undermine exports. Persistently lower oil prices would benefit the external balance, but raise the fiscal deficit absent structural revenue-raising measures.

Vietnam: Risk Assessment Matrix

Event	Up/Down-Side	Likelihood	Impact	Transmission Channels	Policy Recommendations
Public debt/GDP ratio increases further; inadequate fiscal consolidation; private external debt continues rising	↓	**High**	**Medium**	Higher interest rates, exchange rate pressure, weaker confidence, crowding out	Broaden revenue base, reduce exemptions, strengthen administration, introduce a property tax, curtail non-essential spending, civil service reform. Allow greater exchange rate flexibility.
Banking-sector NPLs are exacerbated, high credit growth to real estate and the financial sector create new risks	↓	**Medium**	**High**	Adverse macro-financial feedback loop	Accelerate NPL resolution and recapitalization of systemically important banks, resolve small unviable banks, strengthen safety nets. Reduce credit growth targets, tighten macroprudential policies.
Prolonged drought and salinization events	↓	**Medium**	**Medium**	Successive crop yields underperform, spillovers to trade, transport and agro-industry	Monetary policy should look through first round effects on inflation to possible second round effects. Make fiscal space for mitigation expenditures.
Tighter or more volatile global financial conditions, surge in the U.S. dollar	↓	**High**	**Medium**	Capital outflows pressure exchange rate and reserves, confidence declines	Allow greater exchange rate flexibility, move toward using inflation as a nominal anchor. Accelerate fiscal consolidation, and structural reforms to support confidence and FDI.
Structurally weak growth in key advanced and emerging economies / significant China slowdown	↓	**Medium**	**Medium**	Weaker export growth, FDI and remittances	Allow greater exchange rate flexibility, move toward using inflation as a nominal anchor. Accelerate financial sector, SOE and structural reforms to improve productivity, FDI, and domestic activity.
Persistently lower energy prices	↑ **External** ↓ **Fiscal**	**High**	**Low** **High**	Improved current account balance / lower fiscal revenues	Allow exchange rate flexibility. Strengthen revenue: broaden base, reduce exemptions, strengthen administration, introduce a property tax.
Deeper integration in regional supply chains	↑	**Medium**	**Medium**	Stronger exports, improved current account balance	Allow exchange rate flexibility, strengthen international reserves buffers.
Earlier-than-expected implementation of TPP or further FTAs	↑	**Medium**	**Medium**	Stronger imports, FDI, exports and investment; productivity improvement	Accelerate SOE and market reforms, and adapt the monetary policy framework to focus on inflation stability with more exchange rate flexibility.
Accelerated adoption of monetary policy focus on inflation stability with greater exchange rate flexibility	↑	**Medium**	**Medium**	Increased macroeconomic stability, investment, and reserves	Strengthen monetary policy operational and institutional frameworks, adopt a medium-term inflation objective.

- *Some upside risks exist*. Faster rebalancing in China would benefit finished-goods exports—where Vietnam has already made inroads—and Vietnam is expected to remain among the main beneficiaries of China's rebalancing.[2] Making use of the new more flexible exchange-rate regime while focusing monetary policy increasingly on inflation stability would provide a shock absorber against external shocks, safeguard macroeconomic stability, and permit an increase in reserves. Rapid implementation of the Trans Pacific Partnership (TPP) and other bilateral trade agreements are an upside opportunity that would usher in productivity gains, fuel exports, and incentivize reforms.

[2] "China and the CLMV: Integration, Evolution, and Implications," forthcoming IMF report.

11. The authorities broadly concurred with the near-term outlook and risks, and see opportunities to intensify the pace of reforms. They highlighted the progress made on bank and SOE reforms and stressed their commitment to accelerate implementation as part of their socio-economic plan aimed at growth averaging 6½–7 percent during the next five years. They agreed on downside risks from the drought and potential global and regional volatility, but noted that for the latter, increased exchange-rate flexibility would limit the impact on Vietnam. The slowdown of imports, combined with strong FDI inflows and declining capital outflows has helped replenish international reserves significantly since February. The authorities agreed with the need to reverse the trend of public debt to preserve macroeconomic stability.

POLICY DISCUSSIONS: CEMENTING STABILITY AND SUSTAINABLE GROWTH

Healthy growth and low inflation provide a supportive environment for a second generation of reforms. A growth-friendly fiscal consolidation is a high priority while in the near term monetary policy can be put on hold. Allowing increased use of the new more flexible exchange-rate regime highlights the need to modernize the monetary policy framework. Efforts to recapitalize banks should be pursued and previous macroprudential policy easing unwound, while other elements of banking, SOE, and structural reforms to boost domestic-sector productivity are accelerated.

A. Fiscal Policy: Restoring the Anchor

12. Fiscal policy has been loose in recent years. Deficits have averaged 6½ percent of GDP since 2012. Revenue as a share of GDP dropped in this period, reflecting corporate income tax rate and tariff reductions, tax exemptions and incentives, and declining oil revenues. Current expenditures including interest payments increased, while capital expenditure has been constrained.

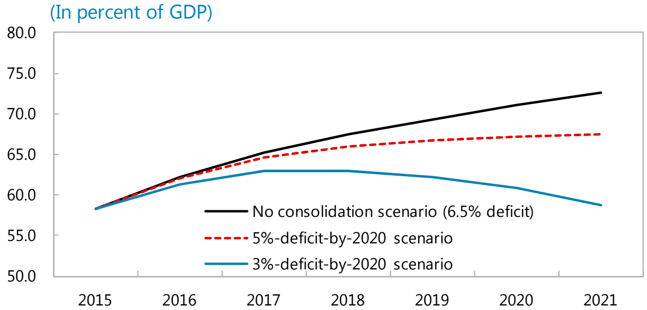
13. Preliminary estimates show the 2015 deficit moderated to 5.9 percent of GDP. The deficit outcome was close to the budget plan, but the composition was markedly different. Revenues rose very strongly, exceeding the budget plan by 2 percent of GDP and reversing the downward trend in the revenue-to-GDP ratio. The overperformance mainly reflected better tax administration, and higher environmental taxes, local government revenue, land user rights sales, and SOE dividends. These more than offset falling oil revenues. Expenditure was higher than planned, reflecting carry-forward spending of 2014 local government revenue, and higher capital and social expenditures. Interest expense also rose.

14. A deficit of 6½ percent of GDP is projected for 2016, the same as the budget plan but with higher revenue and expenditure. Gains made in tax and nontax revenue are projected to be largely sustained in the near term, more than offsetting the impact of a 2 percentage point (to 20 percent) cut in the corporate income tax rate. Carry-forward spending of last year's local government revenue overperformance will occur again. This is estimated to add about 1½ percent of GDP to expenditures compared with the authorities' budget.

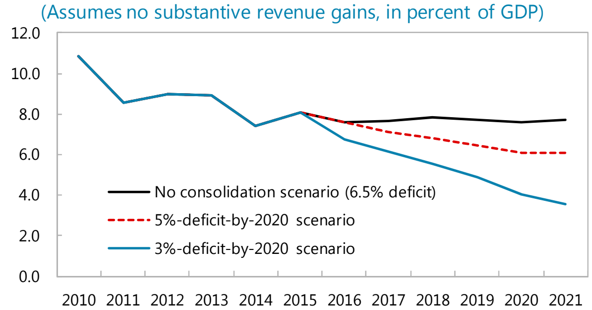
15. Public debt has risen sharply, and the risk of debt distress has climbed. The ratio of public and publicly-guaranteed (PPG) debt to GDP is projected to increase to 62 percent in 2016, up over 16 percentage points in the past five years, reflecting persistently high budget deficits and lower-than-projected nominal GDP due to low inflation. Under staff's baseline projection, which incorporates a modest consolidation to a deficit around 5 percent of GDP in the medium term, PPG debt would rise toward 70 percent of GDP, elevating the risk of debt distress (Appendix 1 debt sustainability analysis).

16. The authorities' draft medium-term budget plan indicates a deficit around 3 percent of GDP by 2020. Such a consolidation would be appropriate, but there are substantial challenges to achieving it. Structural revenue-enhancing policies have yet to be approved, and over the medium term tax exemptions and trade tariff reductions due to trade agreements will undermine buoyancy, and nontax revenues could ease due to declining SOE dividends as equitization (i.e., privatization) advances. The authorities hope to restrain social spending by increasing fees for public healthcare and education to incentivize greater use of private services, but higher fees would also raise social insurance costs. Civil service reform, which could yield substantial savings, is not yet planned. In the absence of revenue enhancements or current savings, the burden of adjustment could fall on large cuts to capital spending, which would undermine growth.

PPG Debt, 2015–2021
(In percent of GDP)



Capital Expenditure, 2010–2021
(Assumes no substantive revenue gains, in percent of GDP)



17. Fiscal consolidation should begin this year with growth-friendly measures and include funds for bank recapitalization. Deficit reduction of ¾ of a percentage point of GDP per year, together with accelerated structural and bank reforms that could gradually boost real GDP growth to its historical average—and the authorities' medium-term objective—of 7 percent, would place the debt ratio on a downward path and mitigate debt distress risk. Using public money to recapitalize state-owned banks up front—estimated at 2½ percent of GDP (see below)—would result in a manageable near-term debt increase, reduce uncertainty, and provide insurance against potentially larger public sector liabilities that could arise if banks were to face heightened distress with weakened capital positions.

Vietnam: Fiscal Consolidation Scenario 1/

(In percent of GDP)

		Consolidation						
	2015 Est.	2016	2017	2018	2019	2020	2021	2022
Total revenue and grants	23.7	23.6	23.9	24.2	24.5	24.8	25.1	25.5
Capital expenditure	8.1	7.7	7.5	7.5	7.5	7.5	7.5	7.5
Non-interest current expenditure	19.6	19.5	19.1	18.8	18.5	18.2	18.0	17.8
Interest expense	2.0	2.1	2.2	2.1	2.1	2.1	2.0	1.9
Net lending (+)/borrowing (-)	-5.9	-5.7	-5.0	-4.3	-3.7	-3.0	-2.4	-1.8
Primary surplus (+)/deficit (-)	-3.9	-3.6	-2.8	-2.2	-1.5	-1.0	-0.4	0.1
Public and public-guaranteed debt 2/	58.3	63.7	65.0	64.9	63.9	62.3	60.2	57.7
Real growth	6.7	6.1	6.5	6.5	6.6	6.8	6.8	7.0
Assumed fiscal multiplier		0.3	0.3	0.3	0.3	0.3	0.3	0.3
Cumulative real growth impact of consolidation (in percentage points)		-0.3	-0.3	-0.4	-0.5	-0.6	-0.7	-1.0

Source: IMF staff.

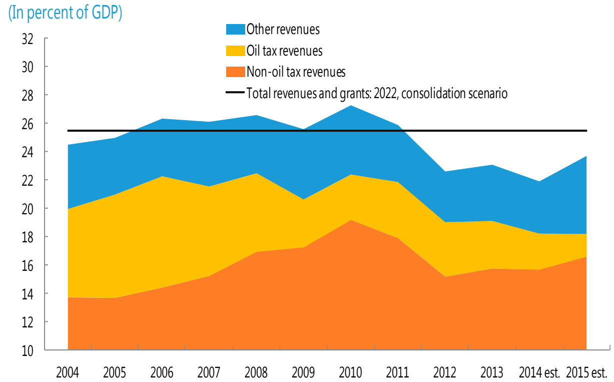
1/ Public guaranteed debt, interest rates, ODA onlending and valuation changes are assumed to be the same as in the baseline.

2/ 2016 PPG debt includes banking restructuring cost, 2.5 percent of GDP.

18. Structural revenue-enhancing policies will be needed to offset the adverse impact of permanent revenue-reducing factors. Measures that could be taken this year include reducing exemptions and incentives, further increasing fuel and environmental taxation while protecting the poor through targeted transfers, eliminating the lower VAT rate of 5 percent, and further strengthening revenue administration. Additional measures that could be implemented subsequently include broadening the tax base by introducing a property, interest income, and capital gains tax and including pensions under personal income tax. Together, these would raise the revenue-to-GDP ratio back to its long-run average. Using equitization proceeds to finance the deficit would further restrain debt and enhance National Assembly oversight of these funds.

Vietnam: Total Revenues and Grants, 2004-15

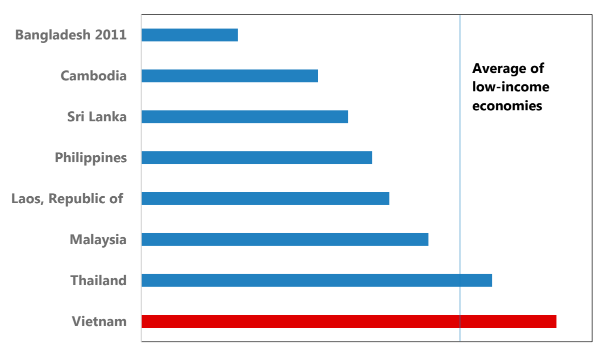
(In percent of GDP)



19. Room exists to rationalize the public wage bill and enhance the efficiency of public spending. Expenditure on public employment is significantly higher than in other countries in the region. A comprehensive civil service reform is needed. Spending on education is commendably higher than in comparable countries in the region and yields good results in primary and secondary education, although there is room to improve vocational and tertiary education (Box 3). Healthcare spending is in line with comparable

Compensation for Public Employees, 2012

(In percent of GDP)



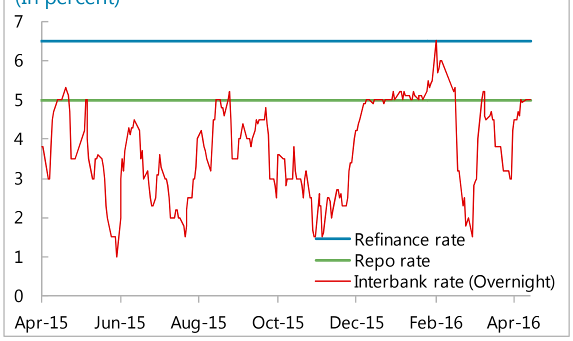
countries and yields good results. Plans to increase the role of the private sector in education and healthcare should proceed carefully to ensure quality and protect access for the poor. Improvements in public capital spending efficiency are needed to narrow the infrastructure gap, with stronger control and coordination at the provincial level.

20. The authorities agreed with the need to reduce the fiscal deficit and arrest the rise in public debt. They emphasized their intention to reduce the deficit to 4 percent on average over the 2016-2020 period, falling to around 3 percent by 2020, and to maintain debt below the legal limit of 65 percent of GDP. They noted staff's medium-term consolidation scenario and advice to broaden the revenue base, and were working on tax policies to raise revenue, expected to be implemented in the next few years. Introduction of a property tax had been studied and the reintroduction of the capital gains tax and unification of the VAT rate at 10 percent were being considered. The authorities also noted their success to date in reducing tax evasion. Increases in tax rates were not planned in the near term. On the expenditure side, the authorities recognized the need to reduce the public wage bill, and they noted plans to increase participation by non-state actors in education and healthcare to reduce costs to the budget. They also highlighted the need to make capital expenditure more efficient, while increasing use of PPPs for infrastructure development. The Ministry of Finance emphasized that bank recapitalization costs should not result in public debt exceeding the legal limit.

B. Monetary and Exchange Rate Policies: Modernizing for a Rising Economy

21. Monetary policy was accommodative over most of last year against the backdrop of falling inflation. Short-term interbank interest rates fluctuated below the SBV's repo rate with abundant liquidity, and banks rapidly expanded lending to meet the SBV's credit growth target. Liquidity conditions were tightened around year end when currency pressures arose.

Vietnam: Interest Rates
(In percent)

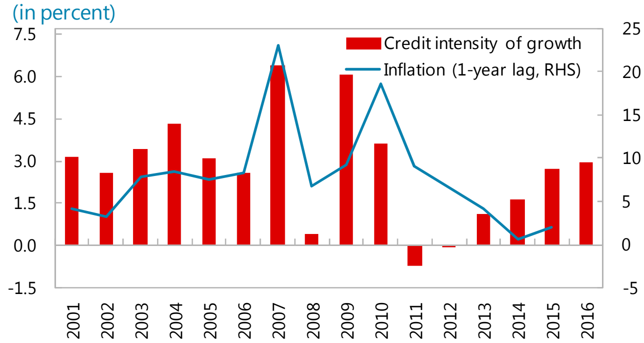


22. Staff recommended keeping monetary policy on hold as the impact of recent shocks feed through the economy. Although headline inflation has risen, this reflects the adverse supply shock to agriculture and administered price changes. Underlying inflation is benign and growth is slowing. If underlying inflation were to pick up due to second-round effects, a tightening would be appropriate. If not, and inflation stalls while growth weakens further, some easing could be considered. With external demand slowing, such an easing could also come about in part through exchange-rate depreciation.

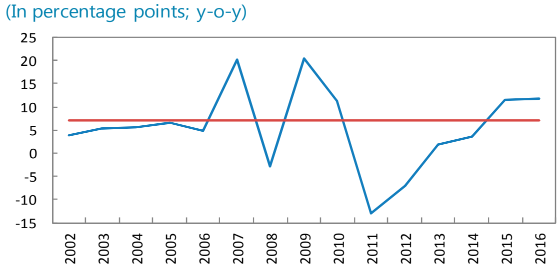
23. Monetary operations should aim to stabilize the overnight interbank interest rate close to the policy repo rate. Improved liquidity management and forecasting would strengthen policy effectiveness. Establishing an interest-rate corridor, with an overnight standing credit facility as the ceiling, a deposit facility as the floor, and the overnight interbank rate guided to the center of the band through liquidity operations, would also enhance effectiveness. Shifts in the corridor would then clearly signal changes in the policy stance.

24. The 2016 credit growth target should not be binding. If met, it would increase the credit intensity of growth and the credit-to-GDP ratio to levels signaling heightened risk and that have been associated with previous periods of macroeconomic instability and elevated inflation in Vietnam. Allowing credit growth to decline to below 15 percent in response to monetary and macroprudential policies would reduce the expansion of the credit-to-GDP ratio below risky levels. Over time, use of administrative measures, including credit growth targets and interest rate ceilings, should be phased out as monetary operations are strengthened. This would make policy settings more coherent, and complement efforts to reform the framework and improve the transmission mechanism.

Vietnam: Credit Intensity of Growth and Inflation
(in percent)



Vietnam: Percentage Change in Credit/GDP, 2002–16 1/
(In percentage points; y-o-y)



1/ The red line represents a year-on-year increase in the credit/GDP ratio by 7 percentage points. Increases of this magnitude have been associated with financial crisis empirically (*GFSR*, September 2011).

25. The adoption of a more flexible exchange-rate regime is commendable and could enhance monetary-policy independence. Use of the new regime should be made to buffer external shocks. Recent foreign exchange intervention to build reserves opportunistically is appropriate. Achieving at least the lower bound of the Fund's reserve adequacy metric—approximately three months of prospective goods and services imports—would strengthen buffers that could be used to smooth periods of substantial volatility.

26. Gradually shifting the monetary-policy framework toward using inflation as the nominal anchor would facilitate greater macroeconomic stability (Box 4). Placing less weight on exchange-rate stabilization would discourage one-way bets. In this context, broader operational, communications and institutional reforms are needed (Box 5). Near term priorities include reforms to strengthen the interest rate instrument and communications with enhanced focus on inflation stability.

27. The authorities emphasized that the SBV conducts monetary policy with inflation control as the primary objective while supporting other objectives from time to time. This had helped maintain macroeconomic stability. They also stressed that the change in exchange-rate policy was a success and contributed to the recent appreciation of the dong by eliminating one-sided expectations. The SBV noted that it would conduct research on enhancing the monetary policy framework and would seek technical assistance from the Fund as needed. In the near term, the authorities indicated they would maintain current policy settings, given that higher headline inflation reflects non-monetary factors. They are monitoring credit growth closely, and while higher targets are supportive of growth, credit is being channeled through policy directives to productive sectors based on individual banks' health, and is thus consistent with continued low inflation and macroeconomic stability.

C. Macroprudential and Banking Policy: Strengthening Macrofinancial Stability

28. The macroprudential framework is being developed. The SBV has proposed establishing a Financial Stability Council, chaired by a Deputy Prime Minister, to coordinate financial stability policies. A new Monetary and Financial Stability Department was formed within the SBV to assess systemic risk, and an annual financial stability report has been prepared though not yet published. To mitigate potential systemic risks, the SBV has proposed macroprudential tightening measures including increasing the risk weight for real estate loans (reversing the previous easing) and reducing prudential ratios governing asset/liability maturity mismatches. At the same time, it proposed raising the loan-to-deposit (LTD) ratio limit for state-owned banks (from 80 to 90 percent), a policy easing.

29. A number of welcome bank reform steps have been taken. These include phasing out explicit loan classification forbearance on new loans; restricting dividend payments at weak performing banks; strengthening on-site supervision and moving towards risk-based supervision; tightening regulations on related-party lending; plans to increase the capital of the Vietnam Asset Management Corporation (VAMC) and allow it to buy and sell NPLs at market rather than book value; and the takeover of three weak banks by the SBV while writing down existing shareholders.

30. Progress has been made in various FSAP recommendations. The SBV is implementing a pilot experiment to identify 10 systemically important banks (D-SIBs) and undertake stress tests on them, and work is underway to enhance their management and supervision. Basel II is being piloted for 10 banks, including most D-SIBs, an early warning system is under construction, and bank data collection and reporting is being strengthened. Less progress has been made in other areas, including crisis management and bank resolution frameworks. As well, accounting standards are not in line with International Financial Reporting Standards (IFRS).

31. The legacy of impaired loans poses ongoing challenges:

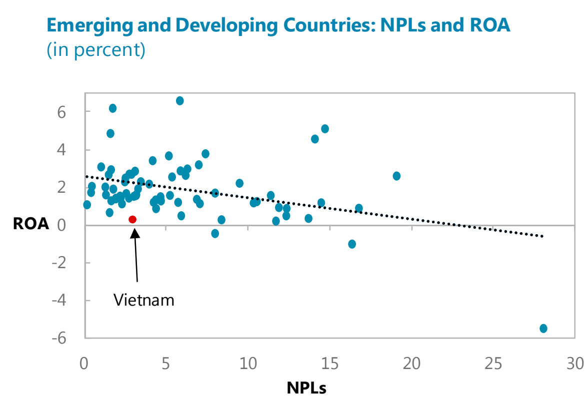
- **Banking-sector profitability remains weak reflecting a high level of impaired loans.** Banks' return on assets (ROA) is 0.5 percent and return on equity (ROE) is 6¼ percent, significantly lower than the averages of emerging and developing countries (about 2 and 15½ percent, respectively). While the reported capital adequacy ratio is 12¾ percent, above the regulatory minimum of nine percent, and the reported NPL ratio has declined to 2.6 percent, measured more broadly to include NPLs sold to VAMC and loans previously restructured yields an impaired loan ratio of about 12½ percent of total loans. This level of impaired loans is at the lower end of estimates based on simple relationships between ROA, ROE, and NPLs for emerging and developing countries.

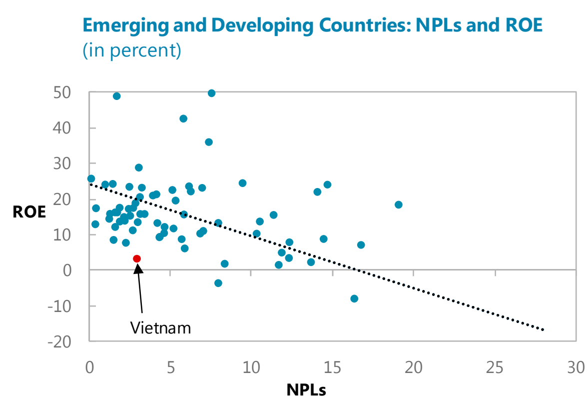
Vietnam: Impaired Loans
(In trillion of Vietnamese dong; unless otherwise indicated)

	Assets	Regulatory capital	Impaired loans, of which: Classified as NPL	Sold to VAMC	Decision 780 loans	Impaired Loan Ratio
State-owned banks	3,304	203	57	130	116	13.7
Private sector banks 1/	3,684	354	72	100	84	11.7

Sources: Data from Vietnam authorities and IMF staff calculations.

1/ Joint stock banks, joint venture banks, fully foreign-owned banks and branches.





- **The VAMC's current operations lack resolution incentives.** Banks provision against NPLs sold to the VAMC over a 5–10 year period; they continue to manage the NPL after selling to the VAMC; and they repurchase the NPL back from the VAMC at the end of the provisioning period. This reduces incentives to resolve impaired loans quickly, and raises reported but not actual capital. The VAMC is making little progress in restructuring or selling NPLs reflecting legal constraints on collateral sale and restructuring, insufficient capacity, and inability to recognize losses. In contrast, the Debt and Asset Trading Corporation (DATC) purchases outright impaired assets with a haircut, permanently removing them from banks' balance sheets.

- **Efforts to attract foreign capital are complicated** by limits on foreign ownership, limited use of international accounting standards and thus transparency, and weakness in banks' governance.

32. The current strategy of allowing banks to recapitalize mainly via retained earnings will take many years and is risky. While financial stability has improved recently with macroeconomic stability and supportive liquidity conditions, banking-sector credit risk and potential stress from rising sovereign indebtedness have increased (Box 6). As well, corporate sector performance has deteriorated, particularly among SOEs, with potential for adverse impact on banks (Box 7). Higher domestic interest rates—related to U.S. Federal Reserve tightening or adverse global macrofinancial shocks—could exacerbate and mutually reinforce sovereign-banking-corporate risks.

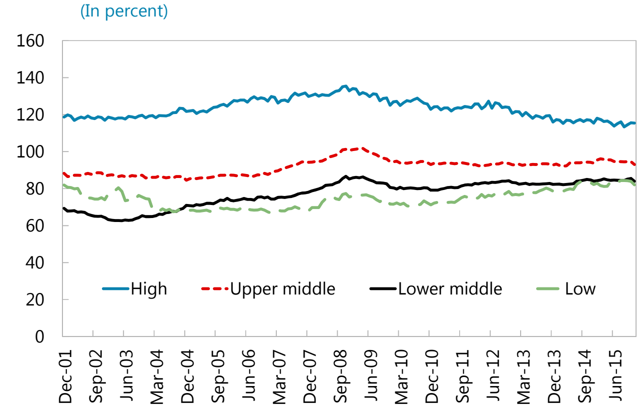
33. Staff recommended broadening reforms. Key elements include: accelerated NPL loss recognition and resolution; recapitalization by existing shareholders, including budget resources for state-owned commercial banks (SOCBs); stronger governance, operational and risk management, and adoption of IFRS reporting; enhanced supervision of SOCBs and equitization to recover initial budgetary recapitalization costs; and orderly resolution of unviable institutions. These efforts should be supported by bank diagnostic assessments and legal reforms: (i) to improve the debt enforcement and collection framework to facilitate collateral sales; and (ii) a specialized resolution regime for financial institutions, including a framework for purchase and assumption transactions. Based on official data, staff estimates recapitalization costs for public banks at around 2½ percent of GDP. Although estimates for private banks suggest no immediate recapitalization needs in aggregate, some banks have moved NPLs off-balance-sheet by establishing their own asset management companies and capital needs for individual banks likely exist.

34. The VAMC should accelerate resolution and sale of NPLs in its portfolio. To fulfill this function and maximize recovery values through enhanced coordination and securitization, the VAMC should be strengthened, permitted to recognize losses, and pass them along to participating banks. Measures include more resources, development of valuation and securitization methodologies, and legal protection for officials involved in the valuation of loans and collateral for sale at market prices. Quantitative performance targets for NPL resolution should be established, and agent bank oversight and incentives strengthened. As well, more institutions need to be licensed to trade in NPLs and collateral.

35. The proposals to tighten macroprudential policy are welcome, as they focus on mitigating financial stability risks, and implementation this year is recommended. The proposed increase in the LTD ratio for state-owned banks would raise it above the average in

Average LTD ratios by Income Level

(In percent)



Sources: IFS and IMF staff calculation.

middle-income countries. Given the lack of liquidity pressures, the increase should be forgone and the LTD limit unified at 80 percent system-wide. More broadly, macroprudential measures should focus on systemic risk and not be used for demand management. If rapid credit growth were to continue despite the proposed measures, broader-based macroprudential tightening to mitigate the build-up of credit risk would be warranted. To increase macroprudential policy effectiveness, a clear communications strategy should be established, and consideration be given to publishing the financial stability report.

36. Building on progress made in strengthening the AML/CFT framework, the authorities are encouraged to strengthen its implementation. Under the leadership of the national AML/CFT committee, Vietnam addressed a number of the technical gaps highlighted in the 2009 APG mutual evaluation report and 2010 FATF assessment. Going forward, the key challenge remains the effective implementation of the framework commensurate with Vietnam's ML/FT risks.

37. The authorities agreed with the thrust of staff's assessment and recommendations. In particular, they agreed with the need to resolve impaired loans in banks and at the VAMC, and recognized that legal constraints to resolve NPLs would need to be removed. They noted that if favorable growth conditions continued the policy of restricting dividend payments at weak performing banks would help build capital over the medium-term, though this would take years. The authorities emphasized that using budget resources to recapitalize state-owned banks would be difficult and current market conditions made attracting new private capital challenging, but they agreed that that public recapitalization costs might be recovered through a strong and well sequenced equitization program. They noted that their macroprudential framework would be finalized soon, systemic risk supervision would be strengthened to ensure financial stability, and the impact of the LTD ratio increase would be monitored carefully. To strengthen AML/CFT, a national risk assessment was under preparation.

D. Structural Reforms: Adding Ingredients for High Sustained Inclusive Growth

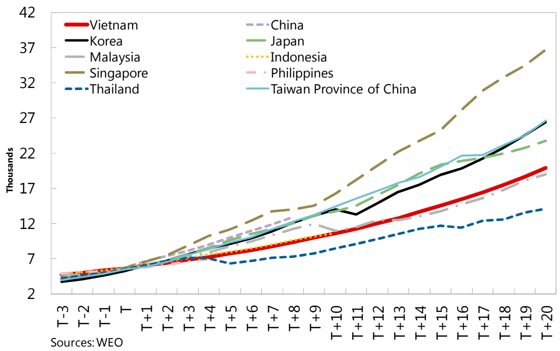
38. Vietnam's growth performance in recent years has been admirable, but it lagged that of East Asia's most successful high-growth countries when they were at a similar level of development (Figures 1 and 2). As well, Vietnam's working-age population share in the overall population has started to decline, and in the longer term this demographic shift could become a drag on growth. Total factor productivity (TFP) growth has declined by about 1½ percentage points since the mid-2000s. Reversing the decline would be essential to achieve a higher, sustainable, and inclusive growth plane.[3] The potential for productivity gains from reallocation of labor is still large,

[3] TFP gains should be achievable with structural reforms. See "Structural Reforms and Macroeconomic Performance; Initial Considerations for the Fund", IMF 2015.

Figure 1. Growth, Labor Force, and Productivity

Even with real growth of 6½ percent, Vietnam would fall short of Asia's most successful growth stories.

PPP per capita

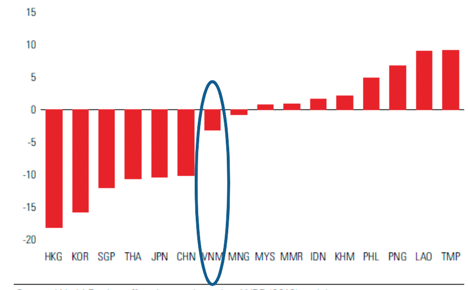


Sources: WEO
Note: T=0 defined as the year when constant PPP GDP per capita reached Vietnam 2014 level. Growth for Vietnam beyond T=0 is set to 6.5 percent.

A continuation of recent growth rates should not be taken for granted since demographic conditions will deteriorate…

Expected Change in Working-age Population

(Percentage change, 2010-2040)



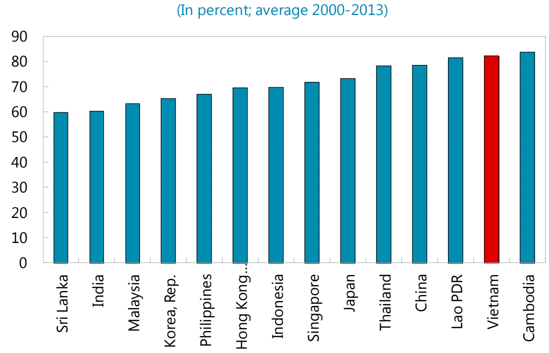
Source: World Bank staff estimates based on WPP (2012) revision.

1/ 15-64 years old

…and there is limited room to counter this by increasing labor force participation.

Overall Labour Force Participation Rates

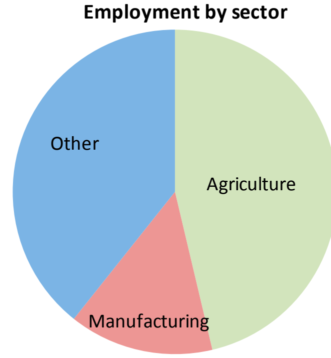
(In percent; average 2000-2013)



Sources: WDI; and IMF staff calculations.

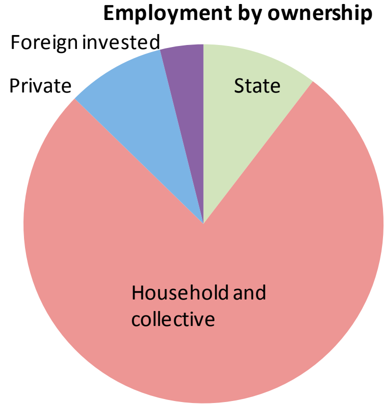
But there is still large potential to boost TFP by reallocating labor from agriculture…

Employment by sector



…and the large state and household sectors…

Employment by ownership



…to more productive sectors.

Output per worker

(in percent of output per worker in foreign invested sector)

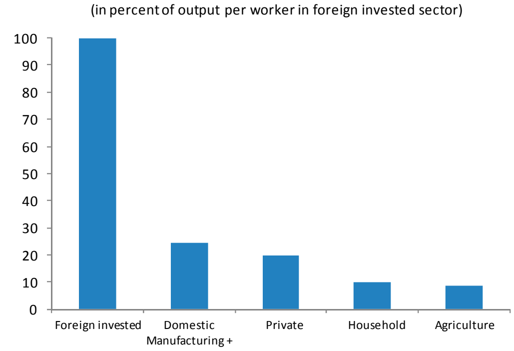
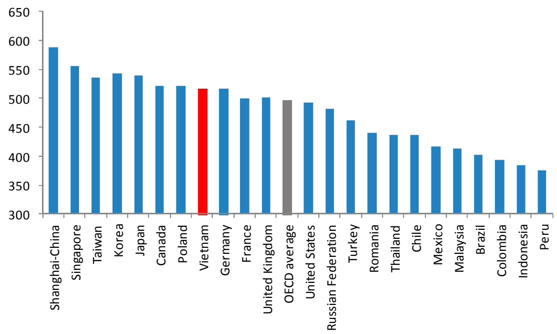


Figure 2. Structural Benchmarking

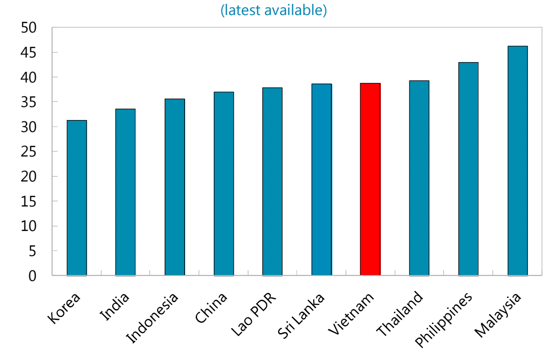
Basic education skills are good.

Pisa 2012 Overall Score



Inequality is in line with regional peers.

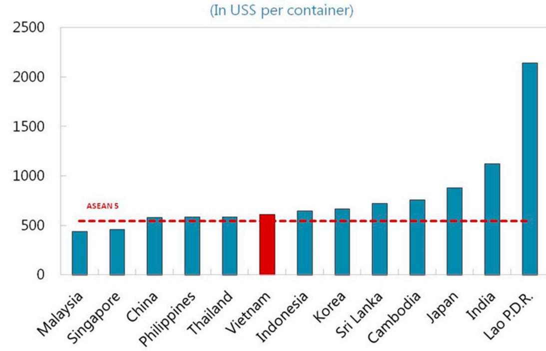
Gini coefficient
(latest available)



Sources: WDI; and IMF staff calculations.

Export performance has been supported by low trade costs and trade agreements…

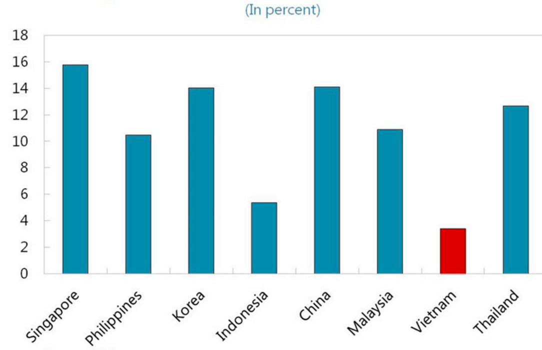
Cost to Export, 2012
(In US$ per container)



Sources: WDI; and IMF staff calculations.

…but overall investment spending growth has been low, with public investment constrained by low revenues.

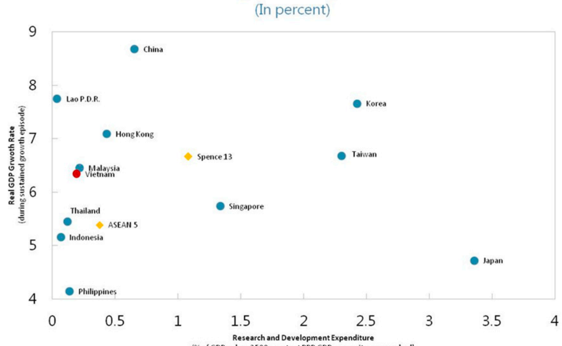
Average Real Investment Growth from T-3 to T+3
(In percent)



Sources: WEO
Note: T=0 defined as the year when constant PPP GDP per capita reached Vietnam 2014 level.

Expenditure on R&D is low compared to what other countries spent at the same stage of development…

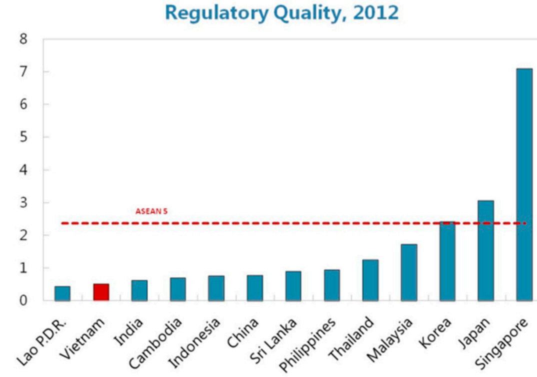
Research and Development Expenditure and Growth
(In percent)



Sources: Penn World Tables; WDI; WEO; and IMF staff calculations.
Note: Sustainable growth episode defined as a period of 25 years after attaining $2500 constant PPP GDP/capita.

…and the governance and regulatory environment requires strengthening.

Regulatory Quality, 2012



Sources: WGI; and IMF staff calculations.

with almost half the workforce in agriculture and three quarters employed at the household level, both with very low productivity.

39. Boosting productivity in domestic manufacturing, and in SOEs which absorb a significant amount of capital, is critical. Output per worker in domestic manufacturing, which includes SOEs, stands at little more than a fifth of that in foreign-invested enterprises. Integration between the foreign-invested sector and domestic suppliers should be deepened to achieve productivity spillovers and to internalize more production value.

40. The state's presence in the economy remains large and overall SOE reform has been slow. Progress has been made on the legal framework for SOE reform including disclosure and transparency requirements, strengthened supervisory capacity, divestment of non-core assets, and defining a limited scope of state-ownership in the economy. However, the state maintains full ownership of more than 700 SOEs, and they continue to enjoy preferential access to production factors including capital and land. The simultaneous control and regulation of major SOEs by line ministries and local governments creates conflicts of interest and is an obstacle to stronger management.

41. Reform of the SOE sector should be accelerated. Key elements include: faster and more comprehensive equitization while ensuring due process; transparency of equitization proceeds and their use; enforcement of disclosure and reporting requirements; governance reforms to address conflicts of interests between regulation and SOE management along with strengthened accountability; continued divestment from non-core areas; restructuring and eventual exit of unprofitable SOEs; and the creation of a level playing field with the private sector by curtailing SOEs' preferential access to credit and other resources. In addition, property rights and the enforcement of competition policy need to be strengthened to encourage domestic private firms to scale up and join the formal sector.[4]

42. Improvements to the business environment are essential to nurture domestic private business. Vietnam ranks 90th in the World Bank's doing business report and scores low in indices of governance quality. Further moves up the value chain are needed, supported by higher and more targeted spending on research and development which is low compared to other countries in the region controlling for the level of development. More efficient public investment to strengthen infrastructure is also needed.

43. Investment in human capital is paying off, but more could be done. Vocational training should be expanded and secondary school attendance increased to address skills mismatches, and health coverage further extended. Inequality in income and opportunities and gender gaps should be addressed through targeted initiatives in education, nutrition and sanitation, and by extending pensions in a financially sustainable manner. A strengthening of environmental policies is needed

[4] See "Vietnam 2035—Toward Prosperity, Creativity, Equity, and Democracy," World Bank and Ministry of Planning and Investment of Vietnam, 2016.

for the sustainability of long-run growth in light of environmental challenges, including climate change (Boxes 8 and 9).

44. The authorities recognized the importance of accelerating SOE and structural reforms for growth. They emphasized progress on the legal framework for SOE reform and improvements in the business environment. They were planning faster reforms of the SOE sector in the 2016–20 period, including greater transparency and disclosure, accelerated equitization, and improved inter-agency coordination. State involvement in the economy would be limited to strategic sectors defined in recent legislation. A list of SOEs that will remain in state ownership was under preparation, and a roadmap to halve their number by 2020 was being developed.

STAFF APPRAISAL

45. Vietnam has achieved a commendable degree of macroeconomic stability and the near-term outlook is broadly positive. Growth is projected to moderate somewhat this year due to a severe drought and softer external demand, but is projected to remain around 6 percent with underlying inflation contained and the current account broadly in balance. Strong FDI inflows are expected to continue, in part reflecting optimism surrounding recent new trade agreements, allowing for some rebuilding of reserves.

46. Notwithstanding recent good performance, legacy risks and widening imbalances create important challenges. Delayed fiscal consolidation has increased debt distress risk. The banking sector requires more capital, impaired loans measured broadly are high particularly in the context of rapid credit growth, and new NPLs could arise if this rapid growth were sustained. Tighter or more volatile global financial conditions could re-ignite capital account pressures and erode already low international reserves absent use of the new more flexible exchange-rate mechanism. Weaker external demand could undermine export-oriented manufacturing, a key engine of growth.

47. A second generation of reforms is needed to mitigate risks and raise the economy's growth potential. Medium-term growth will be challenged by low productivity in the domestic economy, and demographic headwinds will emerge in the longer run. Against this backdrop, the new government's commitment to reforms is encouraging. Accelerating and broadening fiscal, monetary, banking and structural reforms would place Vietnam in a sound position to achieve the authorities' medium-term growth target of 6½–7 percent.

48. A growth-friendly fiscal consolidation is a high priority. Based on the authorities' 2016 budget plan, which indicates no consolidation, public and publicly guaranteed debt is projected to increase to 62 percent of GDP. If fiscal consolidation over the medium term is modest, as in staff's baseline scenario, the debt-to-GDP ratio would breach the authorities' legal limit of 65 percent in the coming years, and approach 70 percent in the medium term, raising the risk of debt distress.

49. Fiscal consolidation should begin this year. The focus should be on structural revenue-enhancing measures to make space for protecting social and infrastructure outlays and recapitalizing state-owned banks. Reducing exemptions and incentives, raising fuel and environment taxes, unifying the VAT at 10 percent, introducing property, capital gains, and interest income taxes, including pensions under personal income tax, and further strengthening revenue administration would raise the revenue ratio back to its long-run average. Comprehensive civil service reform would reduce the large public wage bill, and the efficiency of spending should be strengthened. Directing all SOE equitization proceeds to deficit financing would enhance transparency and assist in debt reduction. Over the medium term, reducing the deficit to 3 percent of GDP, along with structural and bank reforms to achieve sustained robust growth, would reduce debt distress risk.

50. The current monetary policy stance is appropriate and the adoption of a more flexible exchange rate regime is commendable. With underlying inflation low and growth slowing, monetary policy should remain on hold. The new more flexible exchange-rate regime should be used to help buffer external shocks, and the accumulation of international reserves through opportunistic intervention is appropriate. A gradual shift of the monetary policy framework toward using inflation as the nominal anchor would support greater macroeconomic stability. A comprehensive package of operational, communications and institutional reforms would support this transition.

51. Macroprudential policy tightening is appropriate given rapid credit growth. The 2016 credit growth targets are excessive. Allowing credit growth to moderate to below 15 percent would reduce financial stability risks from future NPLs. In this context, the proposed tightening of risk weights for real estate loans and prudential ratios for asset/liability mismatches is welcome, while the proposed increase in the LTD ratio for state-owned banks should be forgone and LTD ratios harmonized at 80 percent system-wide. If rapid credit were to continue despite these measures, consideration would be warranted to broader-based macroprudential tightening to mitigate potential future deterioration in banks' asset quality.

52. Some progress has been made in banking sector reform, but the overall approach of slow provisioning and recapitalization through retained earnings is risky. Banking sector profitability is low reflecting a high level of impaired assets. The VAMC is currently a warehouse for NPLs with little scope to resolve, restructure, or sell them. Additional new capital is needed. In the absence of broader reforms, the system will be susceptible to shocks for many years, raising risks and potential public sector costs.

53. Bolder efforts to restructure NPLs and recapitalize banks are necessary. Faster NPL resolution is needed. At the same time, recapitalization by existing shareholders, including from the budget for state-owned banks, stronger governance and risk management, adoption of IFRS, and subsequent equitization of state-owned banks to offset initial budgetary recapitalization costs would markedly enhance system soundness. These efforts should be flanked by further improvements in supervision and bank diagnostic assessments, and legal reforms to improve the frameworks for debt enforcement and collection, and bank resolution. The VAMC should be permitted to recognize losses, in order to sell NPLs at market prices, and pass them along to banks. It will also require more capital and staffing, development of valuation and securitization methods, and better incentives and legal protection. Licenses to trade NPLs need to be made available to banks and investors to create a market for NPLs.

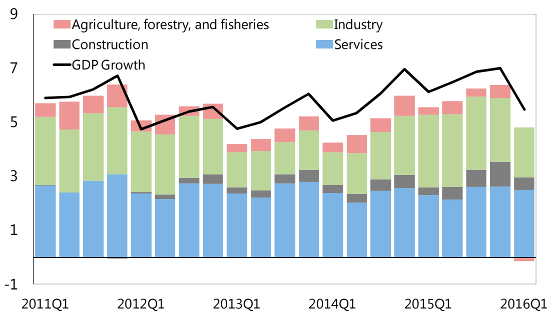
54. Accelerated SOE and structural reforms are needed to achieve a higher growth path. Progress has been made on the legal framework for SOE reform, but implementation has been slow. SOE reform oversight is fragmented, their presence in the economy remains large and stifles private sector growth. Faster reforms should center on accelerated and more comprehensive equitization, greater transparency and disclosure, strengthened governance, and the creation of a level playing field with the private sector. Equitization proceeds and their use should be made transparent. Structural reform priorities include a better business climate, more efficient infrastructure upgrading, and further strengthening of human capital through better vocational and tertiary education.

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

Figure 3. Macroeconomic Developments

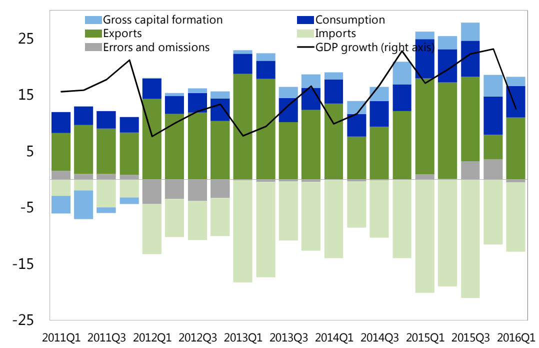
Economic growth has been solid, but agriculture contracted in 2016 Q1 …

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



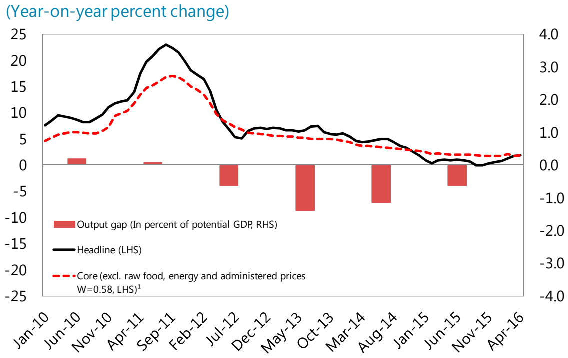
…and export growth has been moderating.

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



Core inflation has fallen to low levels, though headline inflation is ticking up.

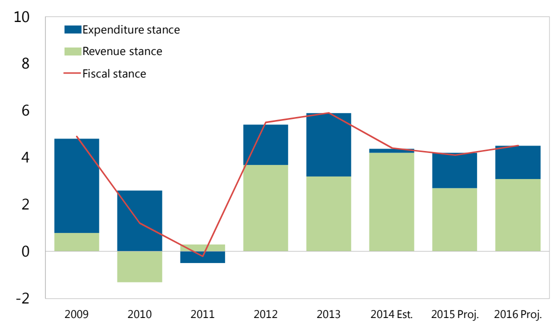
Inflation and Output Gap
(Year-on-year percent change)



¹ W=2014 Weight

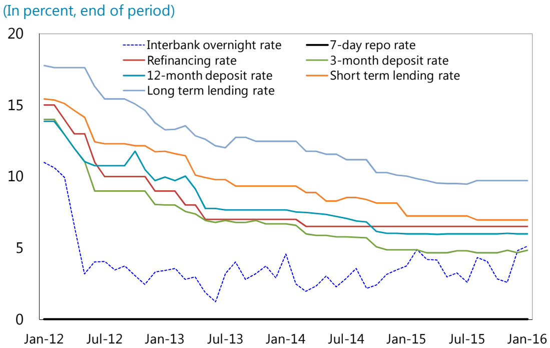
Fiscal policy has been expansionary, mainly due to a stimulative revenue stance.

Revenue and Expenditure Stance
(In percent of GDP)



Monetary policy was accommodative over most of last year, but liquidity was tightened in late 2015.

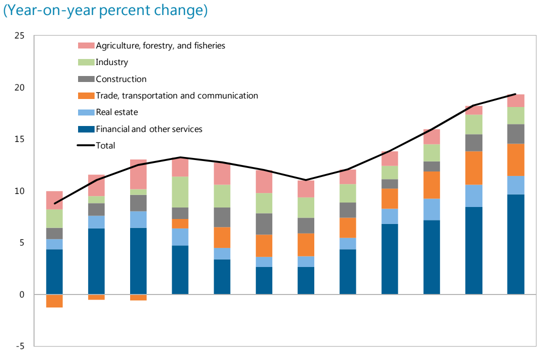
Interest Rates 1/
(In percent, end of period)



1/ Interbank overnight rate is from Bloomberg.

A relaxation of macroprudential policy has enabled rapid credit growth particularly in real estate and financial services.

Contribution to Credit Growth
(Year-on-year percent change)

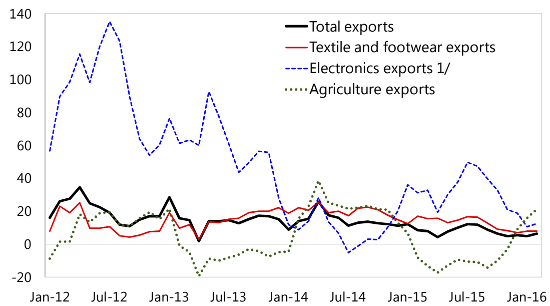


Sources: Vietnamese authorities; Bloomberg LP; and IMF staff estimates.

Figure 4. The External Sector

Exports began to moderate in the second half of 2015 after holding up well through the first half of the year…

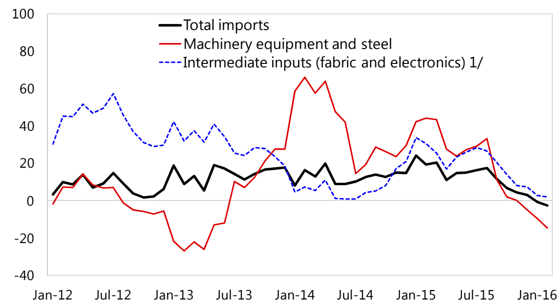
Exports
(3mma, year-on-year percent change)



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

…and import growth also decelerated toward the end of 2015, particularly investment goods and intermediate inputs…

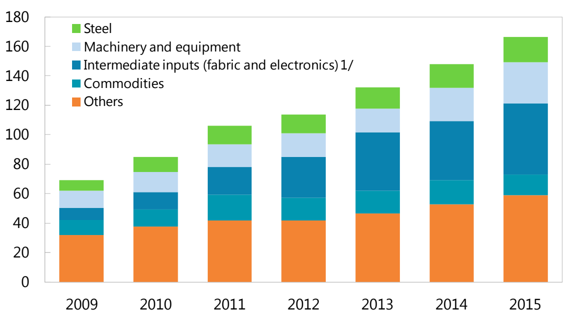
Imports
(3mma, year-on-year percent change)



1/ Electronics also include final goods.

…which account for more than half of imports.

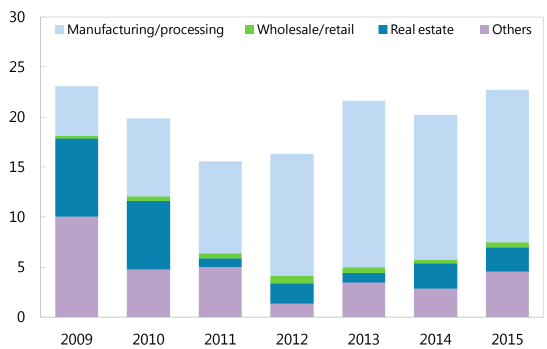
Imports by category
(In millions of USD)



1/ Electronics also include final goods.

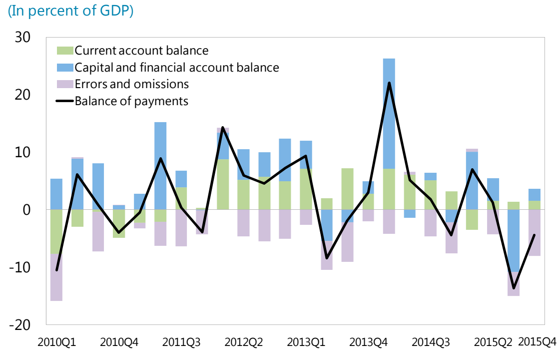
FDI remains strong and concentrated in manufacturing.

FDI Commitments
(In billions of USD)



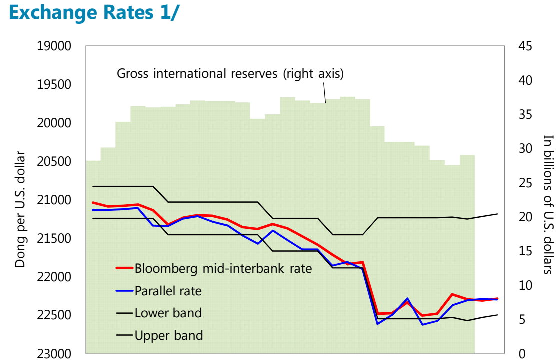
The balance of payments, after strengthening in recent years, came under pressure from capital outflows in the second half of 2015…

Balance of Payments
(In percent of GDP)



…prompting the authorities to depreciate the exchange rate, increase exchange rate flexibility, and intervene using reserves.

Exchange Rates 1/



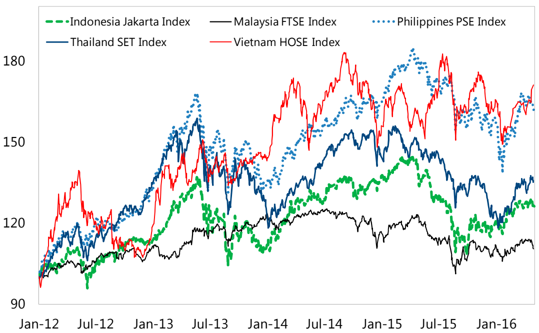
1/ An upward movement indicates an appreciation of Dong.

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

Figure 5. Financial Conditions and Banking Developments

The stock market has been range-bound, outperforming regional bourses...

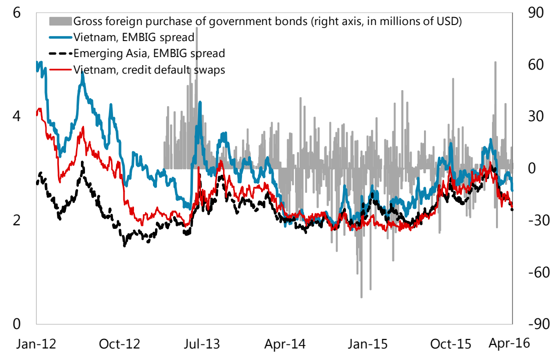
Stock Market Performance 1/
(Index, January 2012=100)



1/ Data as of May 2nd, 2016.

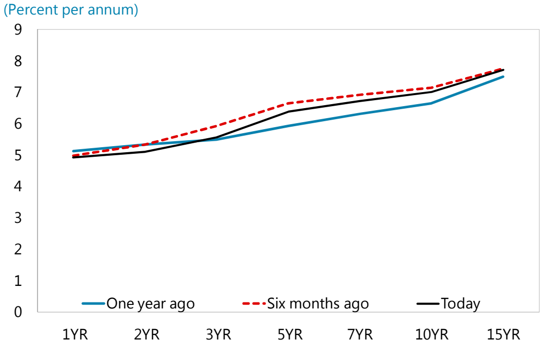
...and sovereign spreads have increased in line with regional EMs.

Sovereign Bond Spreads
(In percentage points)



Government financing costs increased since mid-2015.

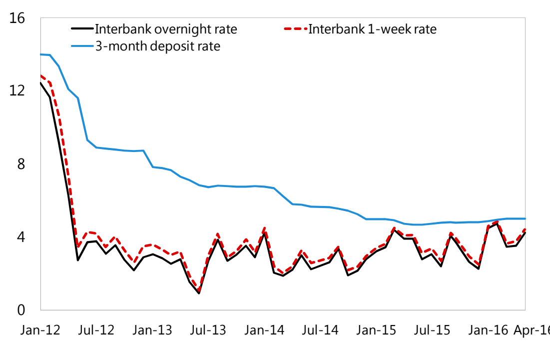
Domestic Bond Yield Curve 1/
(Percent per annum)



1/ Data as of May 2nd, 2016.

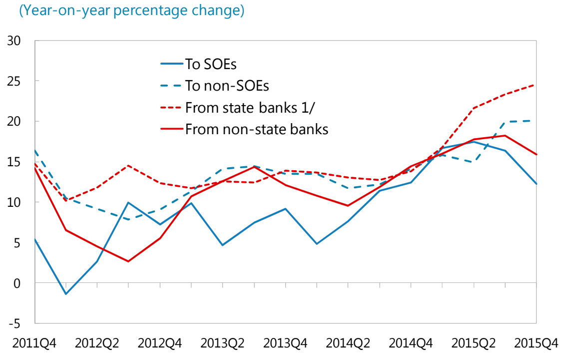
Bank funding costs increased recently as the State Bank of Vietnam tightened liquidity to support the currency.

Interest Rates
(In percent per annum)



Credit growth has accelerated, particularly from state banks ...

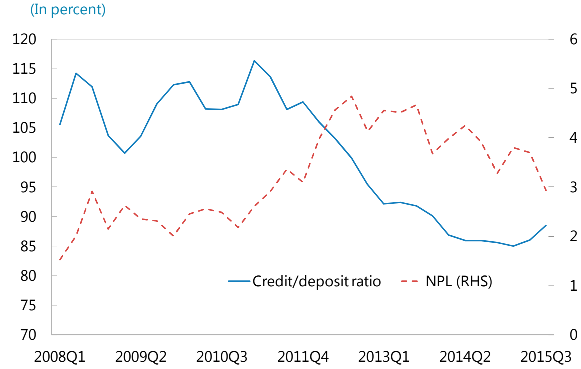
Credit Growth 1/
(Year-on-year percentage change)



1/ Includes the four main state banks: Vietcombank, Incombank, BARD and BIDV.

...although banks' asset quality remains poor.

Credit to Deposit and NPL Ratios
(In percent)

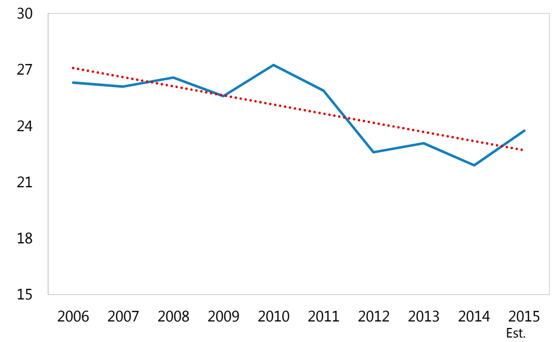


Sources: Vietnamese authorities; Bloomberg LP; and IMF staff estimates.

Figure 6. Sustained fiscal deficits have led to rising public debt

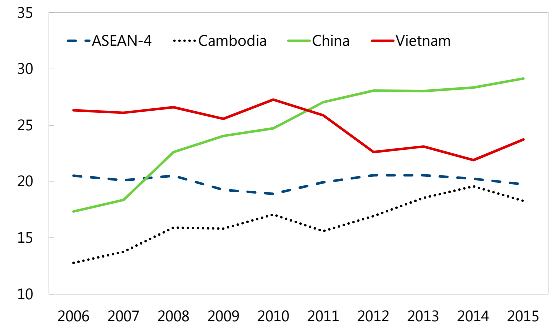
Fiscal revenue has been on a declining trend…

Revenue
(In percent of GDP)



…in contrast to regional experience.

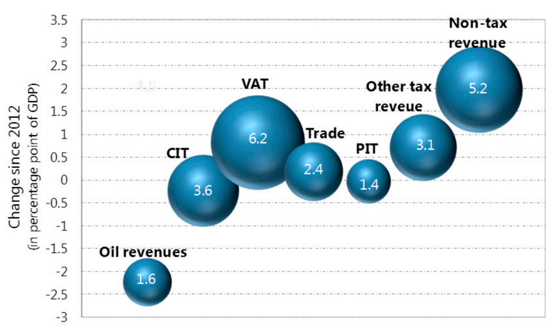
Revenue 1/
(In percent of GDP)



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

Last year, however, weakness in oil and CIT revenues was more than offset by higher VAT, environmental tax, and non-tax revenues.

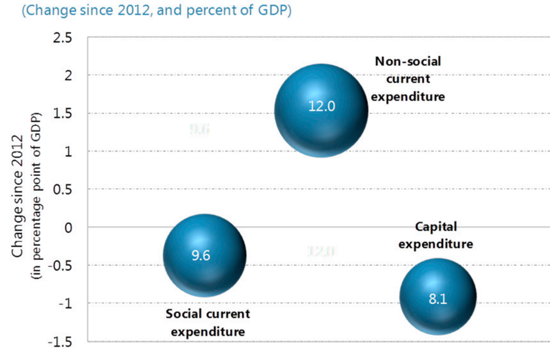
Revenue, 2015 1/
(Change since 2012, and percent of GDP)



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

Capital spending and social current expenditure have been restrained, while non-social current spending has increased.

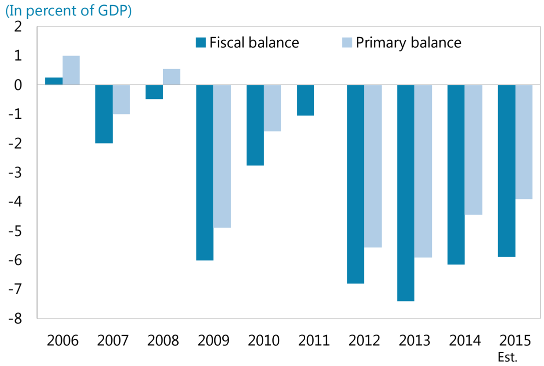
Expenditure, 2015 1/
(Change since 2012, and percent of GDP)



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

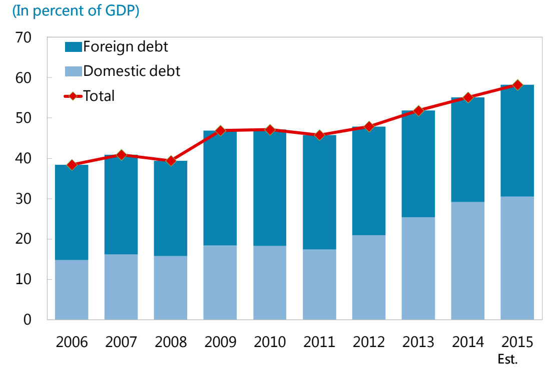
Fiscal deficits have remained high…

Fiscal Balance
(In percent of GDP)



…leading to rising public debt.

Public and Publicly Guaranteed Debt
(In percent of GDP)



Sources: Vietnamese authorities; and IMF staff estimates.

Table 1. Vietnam: Selected Economic Indicators, 2010–17 1/

	2010	2011	2012	2013	Estimates 2014	Estimates 2015	Projections 2016	Projections 2017
Output								
Real GDP (percent change)	6.4	6.2	5.2	5.4	6.0	6.7	6.1	6.2
Prices (percent change)								
CPI (period average)	9.2	18.7	9.1	6.6	4.1	0.6	2.0	3.7
CPI (end of period)	11.7	18.1	6.8	6.0	1.8	0.6	3.5	3.8
Core inflation (end of period)	9.3	13.4	10.7	6.6	3.3	1.4	…	…
General government finances (in percent of GDP) 2/								
Revenue and grants	27.3	25.9	22.6	23.1	21.9	23.7	22.9	22.8
Of which: Oil revenue	3.2	4.0	3.8	3.4	2.5	1.6	1.2	1.4
Expenditure	30.0	26.9	29.4	30.5	28.0	29.6	29.5	28.8
Expense	19.2	18.4	20.4	21.6	20.7	21.6	21.9	21.7
Net acquisition of nonfinancial assets	10.8	8.6	9.0	8.9	7.4	8.1	7.6	7.1
Net lending (+)/borrowing(-) 3/	-2.8	-1.1	-6.8	-7.4	-6.1	-5.9	-6.5	-6.0
Public and publicly guaranteed debt (end of period)	47.1	45.8	47.9	51.8	55.1	58.3	62.1	64.6
Money and credit (percent change, end of period)								
Broad money (M2)	33.3	12.1	18.5	18.8	17.7	16.2	19.7	17.5
Credit to the economy	32.4	14.3	8.7	12.7	13.8	18.8	17.4	16.2
Interest rates (in percent, end of period)								
Nominal three-month deposit rate (households)	11.6	14.9	8.3	6.9	5.0	…	…	
Nominal short-term lending rate (less than one year)	14.0	16.4	12.4	9.7	8.5	…	…	
Balance of payments (in percent of GDP, unless otherwise indicated)								
Current account balance (including official transfers)	-3.8	0.2	6.0	4.5	5.1	0.5	0.3	0.0
Exports f.o.b.	64.1	72.0	73.6	77.4	80.8	84.7	87.3	89.5
Imports f.o.b.	68.6	72.3	68.0	72.3	74.3	80.8	83.2	85.7
Capital and financial account	5.5	4.8	5.6	0.2	2.9	0.9	2.4	2.8
Gross international reserves (in billions of U.S. dollars) 4/	12.4	13.5	25.4	26.0	34.3	28.4	33.7	39.9
In months of prospective GNFS imports	1.4	1.4	2.2	2.0	2.4	1.9	2.0	2.1
Total external debt (end of period)	40.0	37.9	37.4	37.3	38.3	43.1	45.2	46.5
Nominal exchange rate (dong/U.S. dollar, end of period)	19,498	21,035	20,825	21,105	21,385	22,485	…	…
Nominal effective exchange rate (end of period)	103.1	86.7	86.3	88.3	94.0	97.6	…	…
Real effective exchange rate (end of period)	100.1	104.5	108.7	116.1	123.4	127.6	…	…
Memorandum items:								
GDP (in trillions of dong at current market prices)	2,158	2,780	3,245	3,584	3,938	4,193	4,554	4,987
GDP (in billions of U.S. dollars)	112.8	134.6	155.6	170.6	185.9	191.5	200.2	215.4
Per capita GDP (in U.S. dollars)	1,297	1,532	1,753	1,902	2,049	2,088	2,162	2,301

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

Table 2. Vietnam: Balance of Payments, 2010–17

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

	2010	2011	2012	2013	2014	Est. 2015	Projections 2016	2017
Current account balance	-4.3	0.2	9.3	7.7	9.5	0.9	0.5	0.1
Trade balance	-5.1	-0.4	8.7	8.7	12.1	7.4	8.0	8.1
Exports, f.o.b.	72.2	96.9	114.5	132.0	150.2	162.1	174.7	192.7
Imports, f.o.b.	77.4	97.4	105.8	123.3	138.1	154.7	166.7	184.6
Nonfactor services	-2.5	-3.2	-1.4	-3.1	-3.4	-4.3	-4.1	-4.1
Receipts	7.5	8.7	9.6	10.7	11.0	11.2	12.1	13.3
Payments	9.9	11.9	11.1	13.8	14.4	15.5	16.3	17.4
Investment income	-4.6	-4.8	-6.2	-7.3	-8.8	-9.9	-11.5	-12.6
Receipts	0.5	0.4	0.3	0.3	0.3	0.4	0.3	0.3
Payments	5.0	5.2	6.5	7.6	9.2	10.3	11.8	12.9
Transfers	7.9	8.7	8.2	9.5	9.6	7.7	8.1	8.7
Private (net)	7.6	8.3	7.9	8.9	9.1	7.4	7.8	8.4
Official (net)	0.3	0.4	0.3	0.6	0.5	0.3	0.3	0.3
Capital and financial account balance	6.2	6.5	8.7	0.3	5.5	1.6	4.8	6.1
Direct investment (net)	7.1	6.6	7.2	6.9	8.1	10.7	13.0	13.2
Of which: Foreign direct investment in Vietnam	8.0	7.5	8.4	8.9	9.2	11.8	14.2	14.4
Portfolio investment	2.4	1.5	2.0	1.5	0.1	-0.1	0.6	0.6
Medium- and long-term loans	2.8	3.3	4.3	3.5	5.4	5.0	5.1	5.0
Disbursements	4.7	5.7	7.8	8.2	9.8	9.9	10.4	10.9
Amortization	1.9	2.4	3.5	4.7	4.4	4.9	5.4	5.9
Short-term capital 1/	-6.0	-4.8	-4.7	-11.6	-8.0	-14.0	-13.8	-12.8
Change in net foreign assets	-7.1	-6.4	-6.0	-11.7	-9.1	-14.8	-7.4	-6.7
Of which: Commercial banks	-0.5	0.4	0.1	-2.3	-1.5	-5.3	-2.6	-2.4
Trade credit (net)	1.0	1.6	1.3	0.1	1.0	0.8	0.4	0.5
Other short-term capital	...	...	...	...	...	...	-4.2	-4.2
Errors and omissions	-3.7	-5.6	-6.1	-6.9	-6.7	-8.5	0.0	0.0
Overall balance	-1.8	1.1	11.9	1.1	8.3	-6.0	5.3	6.2
Memorandum items:								
Gross international reserves 2/	12.4	13.5	25.4	26.0	34.3	28.4	33.7	39.9
In months of prospective GNFS imports	1.4	1.4	2.2	2.0	2.4	1.9	2.0	2.1
Current account balance (in percent of GDP)	-3.8	0.2	6.0	4.5	5.1	0.5	0.3	0.0
Export value (percent change)	26.5	34.2	18.2	15.3	13.8	7.9	7.8	10.3
Export volume (annual percentage change)	12.3	18.0	20.8	13.1	16.0	17.8	13.0	8.6
Import value (percent change)	19.6	25.8	8.7	16.5	12.0	12.0	7.7	10.7
Import value (in percent of GDP)	68.6	72.3	68.0	72.3	74.3	80.8	83.2	85.7
Import volume (annual percentage change)	10.6	14.1	7.5	17.6	14.6	22.7	12.4	7.6
External debt	44.3	50.0	58.3	63.3	70.6	80.4	89.6	99.4
In percent of GDP 3/	40.0	37.9	37.4	37.3	38.3	43.1	45.2	46.5
GDP	112.8	134.6	155.6	170.6	185.9	191.5	200.2	215.4

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

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

2/ Excludes government deposits.

3/ Uses interbank exchange rate.

Table 3. Vietnam: General Government Budgetary Operations, 2010–17 1/

					Estimates		Plan	Staff Baseline 2/	Projection
	2010	2011	2012	2013	2014	2015	2016	2016	2017
	(In trillions of dong)								
Total revenue and grants	588	719	733	827	863	996	985	1044	1139
Tax revenue	483	608	617	685	718	764	816	816	900
Oil revenues	69	110	125	120	100	68	55	55	68
Non-oil tax revenues	414	497	493	565	618	697	761	761	832
Grants	12	12	10	11	6	12	3	3	2
Other revenue	93	100	106	131	138	219	166	225	237
Expenditure	648	749	954	1093	1105	1243	1277	1342	1436
Expense	414	511	662	773	814	904	964	996	1083
Interest	25	30	40	54	67	83	95	97	111
Other expense	389	481	622	719	747	820	869	899	972
Net acquisition of non-financial assets	234	238	292	320	291	339	313	346	353
Net lending (+)/borrowing (-)	-59	-29	-221	-266	-242	-247	-293	-298	-297
Net incurrence of financial liabilities	169	112	222	263	272	183	279	294	318
Domestic	80	55	176	185	231	128	189	202	219
Securities	60	33	115	131	137	102	…	…	…
Loans	21	22	61	55	96	25	…	…	…
Foreign	89	56	46	78	42	55	90	92	99
Disbursement	99	80	75	105	81	92	120	121	133
Amortization	10	24	28	27	39	39	30	31	35
Net acquisition of financial assets	-109	-82	-1	3	-30	65	14	4	-21
	(In percent of GDP, unless otherwise indicated)								
Revenue	27.3	25.9	22.6	23.1	21.9	23.7	21.6	22.9	22.8
Tax revenue	22.4	21.9	19.0	19.1	18.2	18.2	17.9	17.9	18.1
Oil revenues	3.2	4.0	3.8	3.4	2.5	1.6	1.2	1.2	1.4
Non-oil revenues	19.2	17.9	15.2	15.8	15.7	16.6	16.7	16.7	16.7
Grants	0.5	0.4	0.3	0.3	0.2	0.3	0.1	0.1	0.0
Other revenue	4.3	3.6	3.3	3.7	3.5	5.2	3.6	5.0	4.7
Expenditure	30.0	26.9	29.4	30.5	28.0	29.6	28.0	29.5	28.8
Expense	19.2	18.4	20.4	21.6	20.7	21.6	21.2	21.9	21.7
Interest	1.2	1.1	1.2	1.5	1.7	2.0	2.1	2.1	2.2
Other expense	18.0	17.3	19.2	20.1	19.0	19.6	19.1	19.7	19.5
Net acquisition of non-financial assets	10.8	8.6	9.0	8.9	7.4	8.1	6.9	7.6	7.1
Net lending (+)/borrowing (-)	-2.8	-1.1	-6.8	-7.4	-6.1	-5.9	-6.4	-6.5	-6.0
Net incurrence of financial liabilities	7.8	4.0	6.8	7.3	6.9	4.4	6.1	6.5	6.4
Domestic	3.7	2.0	5.4	5.2	5.9	3.0	4.2	4.4	4.4
Securities	2.8	1.2	3.5	3.6	3.5	2.4	…	…	…
Loans	1.0	0.8	1.9	1.5	2.4	0.6	…	…	…
Foreign	4.1	2.0	1.4	2.2	1.1	1.3	2.0	2.0	2.0
Disbursement	4.6	2.9	2.3	2.9	2.1	2.2	2.6	2.7	2.7
Amortization	0.5	0.9	0.9	0.8	1.0	0.9	0.7	0.7	0.7
Net acquisition of financial assets	-5.1	-3.0	0.0	0.1	-0.8	1.5	0.3	0.1	-0.4
Memorandum items:									
Public and publicly guaranteed debt	47.1	45.8	47.9	51.8	55.1	58.3	62.0	62.1	64.6
Primary balance	-1.6	0.0	-5.6	-5.9	-4.5	-3.9	-4.3	-4.4	-3.7
Non-oil primary balance	-4.8	-4.0	-9.4	-9.3	-7.0	-5.5	-5.5	-5.6	-5.1
Fiscal stance	1.2	-0.2	5.5	5.9	4.4	4.1	…	4.5	4.0
Fiscal impulse	-3.6	-1.5	5.7	0.4	-1.5	-0.3	…	0.4	-0.5
Nominal GDP (in trillions of dong)	2,158	2,780	3,245	3,584	3938	4,193	4,554	4,554	4,987

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

1/ Government Finance Statistics 2001 presentation.

2/ Expenditure includes 66 trn of 2015 revenue overperformance by local governments equally split between capital and current expenditure.

Table 4. Vietnam: Monetary Survey, 2010–17 1/
(In trillions of dong at end-period, unless otherwise indicated)

	2010	2011	2012	2013	2014	Est. 2015	Projections 2016	Projections 2017
Net foreign assets	267	300	548	613	826	836	1,061	1,275
State Bank of Vietnam (SBV)	224	271	522	540	722	614	767	922
Commercial banks	43	29	26	73	104	222	294	354
Net domestic assets	2,523	2,826	3,155	3,788	4,353	5,184	6,144	7,192
Domestic credit	2,690	3,063	3,404	3,876	4,480	5,381	6,359	7,428
Net claims on government	214	232	326	407	530	689	850	1,026
SBV	82	55	43	27	7	83	...	...
Credit institutions	132	177	283	379	523	606	...	...
Credit to the economy	2,476	2,830	3,078	3,470	3,950	4,693	5,509	6,402
Claims on state-owned enterprises (SOEs) 2/	464	489	524	573	644	723	...	...
Claims on other sectors	2,012	2,341	2,553	2,897	3,306	3,970	...	...
In dong	1,990	2,264	2,540	3,010	3,458	4,267	...	...
In foreign currency	485	567	538	460	491	425	...	...
By state-owned banks (SOCBs)	1,107	1,270	1,427	1,625	1,850	2,304	...	...
By non-SOCBs	1,254	1,432	1,511	1,694	1,939	2,247	...	...
Other items net	-167	-237	-249	-88	-127	-198	-215	-235
Total liquidity (M2)	2,789	3,126	3,703	4,401	5,179	6,020	7,206	8,467
Dong liquidity	2,273	2,588	3,228	3,852	4,613	5,370	...	...
Deposits	1,935	2,217	2,773	3,345	3,988	4,643	...	...
Currency outside banks	338	371	456	507	625	727	...	...
Foreign currency deposits	517	538	475	549	566	650	...	...
Memorandum items:								
Money multiplier 3/	6.3	6.0	5.6	6.3	6.3	6.1	6.2	6.2
Velocity	0.8	0.9	0.9	0.8	0.8	0.7	0.6	0.6
Reserve money (year-on-year percent change)	4.1	18.9	25.4	6.1	18.7	19.3	18.4	17.5
Liquidity (M2; year-on-year percent change)	33.3	12.1	18.5	18.8	17.7	16.2	19.7	17.5
Currency/deposits (in percent)	13.8	13.5	14.0	13.0	13.7	13.7	...	...
Credit/deposits (total, in percent)	101.0	102.7	94.8	89.1	86.7	88.7	86.9	86.0
Credit/deposits (dong, in percent)	102.9	102.1	91.6	90.0	86.7	91.9	...	...
Credit/deposits (foreign currency, in percent)	93.9	105.3	113.3	83.7	86.8	65.5	...	...
Credit to the economy								
Total (in percent of GDP)	114.7	101.8	94.8	96.8	100.3	111.9	121.0	128.4
Total (year-on-year percent change)	32.4	14.3	8.7	12.7	13.8	18.8	17.4	16.2
In dong (year-on-year percent change)	29.0	13.7	12.2	18.5	14.9	...	...	...
In FC (year-on-year percent change)	48.4	16.8	-5.1	-14.5	6.9	...	...	...
In FC at constant exchange rate (year on year percent char	40.7	6.1	-5.0	-15.3	6.0	...	...	...
To SOEs (year-on-year percent change) 2/	-15.7	5.4	7.2	9.2	12.5	...	...	...
To other sectors (year-on-year percent change) 2/	52.5	16.4	9.1	13.5	14.1	...	...	...
To SOEs (percent of total) 2/	18.7	17.3	17.0	16.5	16.3	...	...	...
Dollarization								
Foreign currency deposits/total deposits (in percent)	21.1	19.5	14.6	14.1	12.4	...	...	...
Foreign currency loans/total loans (in percent)	19.6	20.0	17.5	13.3	12.4	...	...	...
Banks' net foreign exchange position (USD millions) 4/	583	2,816	4,277	-796	1,373	...	...	...
Government deposits (in percent of GDP)	2.7	2.4	2.3	3.0	2.3	...	...	...
Nominal GDP (in trillions of dong)	2,158	2,780	3,245	3,584	3,938	4,193	4,554	4,987

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

Table 5. Vietnam: Medium-Term Projections, 2010–21

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Estimates		Projections					
Output	(Percent change)											
Real GDP	6.4	6.2	5.2	5.4	6.0	6.7	6.1	6.2	6.2	6.2	6.2	6.2
Prices												
CPI (period average)	9.2	18.7	9.1	6.6	4.1	0.6	2.0	3.7	3.9	4.0	4.0	4.0
CPI (end of period)	11.7	18.1	6.8	6.0	1.8	0.6	3.5	3.8	4.0	4.0	4.0	4.0
GDP deflator	12.1	21.3	10.9	4.8	3.7	-0.2	2.4	3.1	3.6	3.8	3.8	3.9
General government finances 1/	(In percent of GDP, unless otherwise indicated)											
Revenue and grants	27.3	25.9	22.6	23.1	21.9	23.7	22.9	22.8	22.8	22.6	22.3	22.2
Expenditure	30.0	26.9	29.4	30.5	28.0	29.6	29.5	28.8	28.4	27.8	27.3	27.1
Expense	19.2	18.4	20.4	21.6	20.7	21.6	21.9	21.7	21.6	21.4	21.2	21.0
Net acquisition of nonfinancial assets	10.8	8.6	9.0	8.9	7.4	8.1	7.6	7.1	6.8	6.4	6.1	6.1
Net lending (+)/borrowing(-)	-2.8	-1.1	-6.8	-7.4	-6.1	-5.9	-6.5	-6.0	-5.5	-5.3	-5.0	-5.0
Non-oil primary balance	-4.8	-4.0	-9.4	-9.3	-7.0	-5.5	-5.6	-5.1	-4.6	-4.3	-3.9	-3.7
Public and publicly guaranteed debt (end of period)	47.1	45.8	47.9	51.8	55.1	58.3	62.1	64.6	66.0	66.7	67.2	67.5
Balance of payments												
Current account balance	-3.8	0.2	6.0	4.5	5.1	0.5	0.3	0.0	0.1	0.3	0.5	0.8
Exports f.o.b.	64.1	72.0	73.6	77.4	80.8	84.7	87.3	89.5	92.7	97.1	102.3	107.9
Imports f.o.b.	68.6	72.3	68.0	72.3	74.3	80.8	83.2	85.7	89.1	93.2	98.1	103.2
Capital and financial account (net)	5.5	4.8	5.6	0.2	2.9	0.9	2.4	2.8	3.2	3.3	3.3	3.3
Gross international official reserves (in billions of U.S. (	12.4	13.5	25.4	26.0	34.3	28.4	33.7	39.9	47.6	57.0	67.6	80.0
In months of prospective GNFS imports	1.4	1.4	2.2	2.0	2.4	1.9	2.0	2.1	2.2	2.3	2.4	2.6
Total external debt (in billions U.S. dollars)	44.3	50.0	58.3	63.3	70.6	80.4	89.6	99.4	107.8	116.6	125.7	135.4
In percent of GDP	40.0	37.9	37.4	37.3	38.3	43.1	45.2	46.5	46.4	46.1	45.8	45.4
Memorandum items:												
Nominal GDP (in trillions of dong)	2,158	2,780	3,245	3,584	3,938	4,193	4,554	4,987	5,488	6,051	6,670	7,363
Nominal GDP (in billions of U.S. dollars)	112.8	134.6	155.6	170.6	185.9	191.5	200.2	215.4	233.9	254.7	276.8	300.6
Per capita GDP (in U.S. dollars)	1,297	1,532	1,753	1,902	2,049	2,088	2,162	2,301	2,473	2,665	2,866	3,091

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

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

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

Goal/Target		Progress	Status
Goal 1: Eradicate extreme poverty and hunger			
Target 1	Reduce extreme poverty by half between 1990 and 2015	Poverty reduced by three-quarters between 1990 and 2008	Achieved
Target 2	Reduce hunger by half between 1990 and 2015	Proportion of population below minimum consumption reduced by more than three-quarters between 1993 and 2012	Achieved
Goal 2: Achieve universal primary education			
Target 3	Universal primary schooling by 2015	Net enrollment ratio in primary education at 98.1 enrollees per 100 children	Achieved
Goal 3: Promote gender equality			
Target 4	Eliminate gender gaps in primary education no later than 2015	Ratio of girls to boys in primary education of 0.99 in 2014	Achieved
Goal 4: Reduce child mortality			
Target 5	Reduce by two-thirds between 1990 and 2015, the under-five mortality rate	Reduced by 60 percent between 1990 and 2014 (down from 51 to 22 deaths per 1,000)	Nearly achieved
Goal 5: Improve maternal health			
Target 6	Reduce maternal mortality by three-quarters, between 1990 and 2015	Fell from 233 per 100,000 births in 1999 to 54 in 2015	Achieved
Goal 6: Combat HIV/AIDS and other diseases			
Target 7	By 2015, halt and begin to reverse the spread of HIV/AIDS	Infection rate is on upward trend; 0.5 per year per 100 people aged 15-49 in 2014	Unlikely to be achieved
Target 8	By 2015, halt and reverse the incidence of tuberculosis (TB)	Cases reduced by 45 percent in 2014	Achieved
Goal 7: Ensure environmental sustainability			
Target 9	Embrace sustainability and reverse the loss of forests	Forest cover up but loss in closed-canopy forest and biodiversity	Likely to be achieved
Target 10	Halve by 2015, share of people without safe drinking water and basic sanitation	98 percent with access to improved water source in 2015; sanitation access was greatly enhanced	Achieved

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

1/ As of December 2015.

Box 1. Vietnam: Trade Developments, TPP, and FTAs

Structural reforms are necessary to continue export success and ensure spillovers from the FDI sector to the domestic economy.

Vietnam is among the world's most open economies, with trade amounting to about 160 percent of GDP. It has increased world export and import market shares roughly fivefold in the last 15 years. Export growth has been particularly strong in labor-intensive manufacturing of apparel/footwear and, more recently, electronics. Vietnam has captured a larger market share of global exports of major low-end manufacturing goods than any other country in recent years, while China's market share in this category has declined. Gains in final electronics export market share have been similarly impressive, with only China achieving larger gains. As a result, Vietnam's export product mix has shifted from commodities to manufacturing. Geographically, exports are diversified with the U.S., the EU, and other non-East-Asian countries accounting for about 20 percent each, while China and Japan account for just under 10 percent each.

Vietnam's manufacturing export growth is largely driven by FDI with major inflows from Korea, Japan, Singapore, and Taiwan Province of China. FDI inflows accelerated in the run-up to Vietnam's WTO accession in January 2007 from an annual average of US$2.5 billion from 2000–05 to an annual average of US$8.4 billion from 2008–14. The FDI sector's share in Vietnam's total exports has reached 70 percent. Through multinational investments, Vietnam is embedded in global and Asian supply chains. Analysis of gross and value added data shows that multinationals tend to use Vietnam for final assembly with comparatively high foreign value added content.[1] Accordingly, imports of intermediate and investment goods have been rising fast in recent years, with China supplying ⅓ of imports.

Trade agreements and competitive wages have been key ingredients for Vietnam's export success. Import tariffs have been gradually reduced, while most quantity restrictions have been removed. Vietnam has entered into a number of bilateral, regional, and multilateral trade agreements.

Vietnam's Free Trade Agreements

	Name	Status
1	ASEAN Free Trade Agreement (AFTA)	Effective
2	ASEAN–China Free Trade Agreement (ACFTA)	Effective
3	ASEAN–Korea Free Trade Agreement (AKFTA)	Effective
4	ASEAN–Japan Comprehensive Economic Partnership (AJCEP)	Effective
5	ASEAN–Australia/New Zealand Free Trade Agreement (AANZFTA)	Effective
6	ASEAN-India Free Trade Agreement (AIFTA)	Effective
7	Vietnam–Japan Economic Partnership Agreement	Effective
8	Vietnam–Chile Free Trade Agreement	Effective
9	Vietnam–Laos Trade Agreement	Signed Mar-2015, pending ratification
10	Vietnam–Korea Free Trade Agreement	Signed May-2015, pending ratification
11	Vietnam–Eurasian Economic Union FTA	Signed May-2015, pending ratification
12	Vietnam–EU Free Trade Agreement	Signed Dec-2015, pending ratification
13	Trans-Pacific Partnership (TPP)	Signed Feb-2016, pending ratification
14	Regional Comprehensive Economic Partnership	Negotiating

Box 1. Vietnam: Trade Developments, TPP, and FTAs (concluded)

The Trans-Pacific Partnership (TPP) is of particular importance. It has the potential to increase the efficiency of domestic markets (services, SOEs, procurement), promote institutional convergence and technology transfers, and lower the cost of capital. Partly because of its lower starting point, Vietnam could be one of the biggest gainers, with estimates suggesting GDP could rise by a cumulative 8 percent, and exports by 30 percent, by 2030 (TPP countries now account for 39 percent of Vietnam's exports). TPP will provide opportunities to penetrate major markets further and support FDI inflows if investors locate to Vietnam to access TPP markets. By eliminating or reducing tariff lines on industrial and agricultural products, TPP could boost major products in which Vietnam already enjoys advantages. Textile, apparel and footwear industries are considered possible winners due to their well-established position in the global supply chain. TPP's strict regulations such as the "yarn forward" rules of origin[2] could result in on-shoring of textile and other input manufacturing, reducing the sector's heavy dependence on imports from China and improving the trade position. Seafood and agriculture exports could also benefit. On the other hand, the livestock and dairy industries could face difficulties due to lower cost competitiveness and a phasing out of import duties.

Increasing productivity is one of the many challenges that Vietnam must respond to when implementing TPP. While foreign-invested enterprises perform well, Vietnam's domestic sector lacks competitiveness, as reflected in a sizable domestic-sector trade deficit. In particular, SOE reform will be a priority challenge for Vietnam, as TPP requires SOEs to operate on market principles, with a level playing field for regulations, subsidies, and investments, and improved transparency. TPP does, however, allow Vietnam to provide a one-time capital injection to SOEs for restructuring. Another challenge will be protection of labor rights in areas where Vietnam has not ratified ILO conventions. Finally, the elimination of tariff lines will have an adverse fiscal impact. Vietnam's average tariff is around 9½ percent, and trade revenues currently amount to 2½ percent of GDP. About 65 percent of Vietnam's import tariff lines (for TPP members) will be eliminated upon commencement, 85 percent four years later and 98 percent after a decade. For trading partners' tariff lines on Vietnam's exports, 80 to 95 percent will be eliminated on commencement, focused on agriculture, fisheries, textile and apparel products, footwear, wooden furniture, electrical, electronics, and rubber.

---

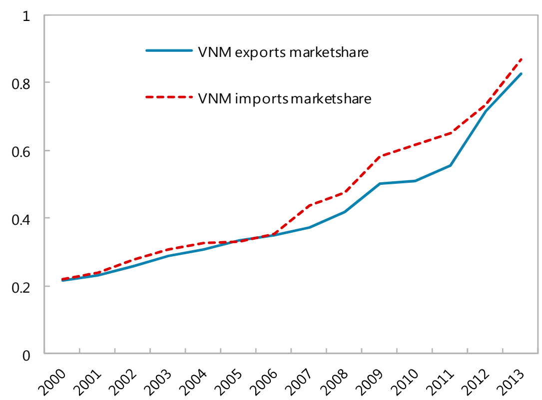
[1] "China and the CLMV: Integration, Evolution, and Implications," forthcoming IMF report.

[2] The rules require Vietnam to use a TPP member-produced yarn in textiles in order to receive duty-free access to TPP member markets. As of now, Vietnam depends heavily on China—not a TPP member—for yarn and textile materials.

Vietnam: Trade Developments

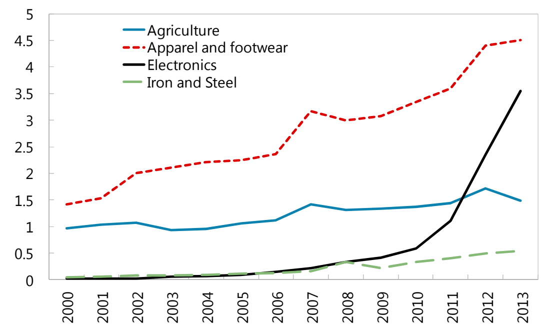
Vietnam has rapidly integrated in world trade making it one of the world's most open economies…

Vietnam Marketshare
(In percent of world trade)



…while gaining market share in apparel/footwear and, more recently, in electronics.

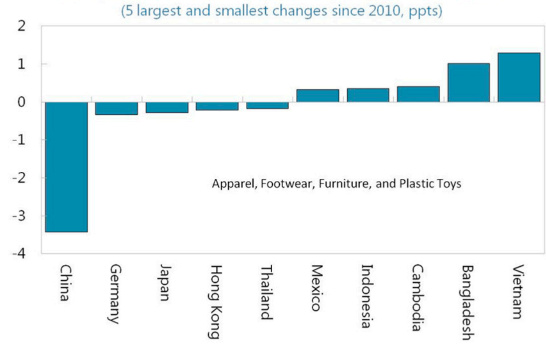
Vietnam Marketshare by product group
(In percent of world exports)



Sources: UN Comtrade; and IMF staff calculations.

Vietnam had the largest gains in export market share of major low-end manufacturing goods globally in recent years…

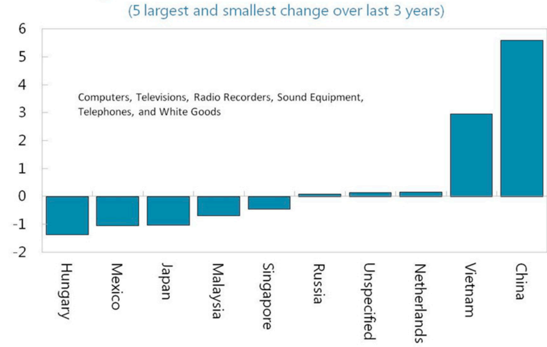
Change in Market Share in Major Low End Goods
(5 largest and smallest changes since 2010, ppts)



Sources: Comtrade, Staff Estimates

…and the second largest gains in global export market share of final electronics after China.

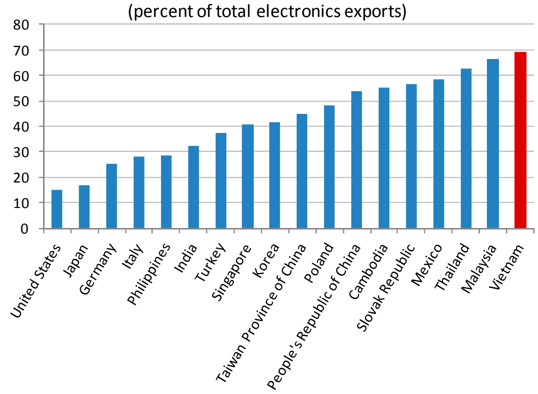
Change in Market Share in Final Electronics Goods
(5 largest and smallest change over last 3 years)



Sources: Comtrade, Staff Estimates

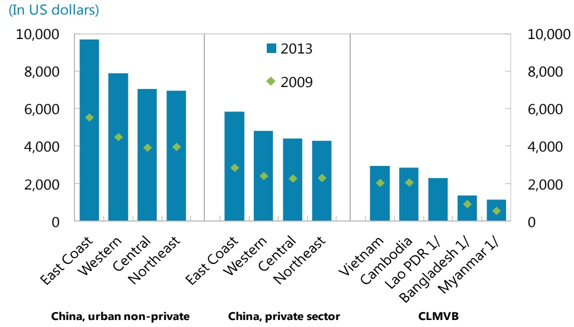
Foreign value added in exports such as electronics is high suggesting a high degree of assembly activity.

Foreign value added in electonics
(percent of total electronics exports)



Competitive wages have helped in attracting labor-intensive manufacturing FDI.

Annual Average Wage
(In US dollars)



Sources: CEIC; JETRO; and IMF staff estimates and calculations.
1/ Estimated wage of workers in manufacturing.

Box 2. Vietnam: External Assessment

No clear evidence of exchange rate misalignment exists, but international reserves are below desirable levels.

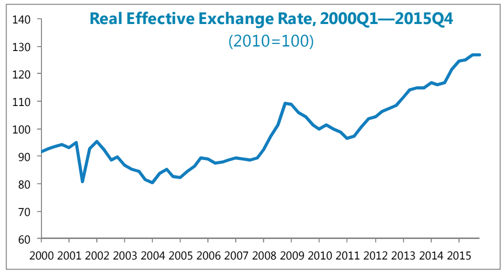
The real effective rate has appreciated strongly since 2011, when the external current account balance swung into surplus on the back of growing trade surpluses by foreign-invested enterprises (FIEs), and a narrowing domestic sector trade deficit. Since early-2015, the dong has appreciated in real effective terms by around 4 percent as the U.S. dollar has strengthened. This occurred despite three 1-percent step devaluations and the move toward a more flexible regime.

The external balance assessment (EBA), undertaken using the EBA-Lite tool, provides no clear evidence of misalignment. The EBA-Lite current account analysis indicates a current account norm of -6.2 percent of GDP, suggesting that the real exchange rate is undervalued by around 11½ percent. The equilibrium real exchange rate (REER) approach, on the other hand, points to substantial overvaluation of about 23 percent. However, the two models show a very weak fit with Vietnam's current account and REER respectively, due to the fact that they do not account for the segmented nature of the trade sector. A staff-estimated model—that demonstrates a stronger fit with the current account, particularly recent years' data—leads to a current account norm of 0.3 percent of GDP, suggesting a small undervaluation of around 0.3 percent.

Capital and financial flows have been dominated by foreign direct investment (FDI) inflows and short-term capital outflows. FDI continued rising in 2015, mainly to the export-orientated manufacturing sector. Short-term capital outflows surged beginning in mid-2015, significantly reducing the financial account, but reversed in early 2016. Finally, external borrowing has slowly increased reflecting slightly higher private and publicly-guaranteed debt.

Vietnam's international reserves increased in the period up to mid-2015, but declined quite sharply thereafter due to intervention. They were around 2 months of imports of goods and services at end-2015, well under the nine months average of regional emerging market countries. According to the IMF reserve adequacy metric they are below the minimum level desirable for a fixed exchange rate regime, but would be considered in the adequate range if greater use was made of the new more flexible exchange-rate regime.

Real Effective Exchange Rate, 2000Q1—2015Q4
(2010=100)

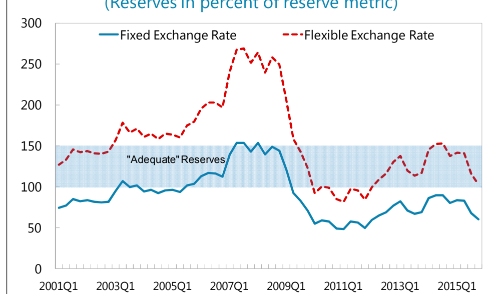


EBA-Lite Results

Approach	Current Account[1]	Current Account, Adjusted[2]	REER[1]
2015 Current Account	0.5%	0.5%	
Current Account Norm	-6.2%	0.3%	
Current Account Gap	6.6%	0.2%	
o/w Policy Gap	-0.6%	0.1%	
ln(REER) Actual			4.79
ln(REER) Norm			4.56
o/w Policy Gap			0.06
REER gap	**-11.6%**	**-0.3%**	**22.9%**

Source: IMF staff estimates.
[1] EBA-Lite standard models.
[2] Staff estimated Current Account model, including Vietnam and its 10 biggest trade partners.

Reserve Adequacy Metric Dynamics, 2000Q1–2015Q4
(Reserves in percent of reserve metric)



Sources: Vietnamese authorities; and IMF staff estimates

Regional Comparison of Reserve Indicators, 2015

	Months of Imports of G&S[1]	Percent of Exports of G&S	Percent of Broad Money	Percent of Short-Term Debt	Percent of GDP
China	21	141	16	360	31
India	8	79	20	350	17
Indonesia	7	62	31	222	12
Malaysia	6	45	26	116	32
Philippines	11	113	41	493	28
Singapore	7	48	46	…	85
Sri Lanka	4	42	22	104	9
Thailand	8	57	32	291	40
Average[2]	9	74	29	277	32
Vietnam	**2**	**16**	**11**	**235**	**15**

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

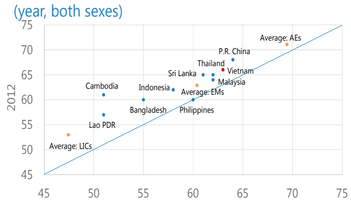
Box 3. Vietnam: Public Spending Efficiency

Public spending on health has been efficient, while room exists to improve the efficiency of education and capital spending.

Vietnam's spending on education is high by regional standards and health spending is in line with the regional average, but its stock of public capital is relatively low. Public spending in 2015 on education was 4.5 percent of GDP and on health 1.7 percent of GDP. This compares to regional averages over 2007–11 of 3.0 percent and 1.7 percent of GDP, respectively. In the area of capital spending, Vietnam lags, with public capital stock per capita at US$2,472 (in PPP terms), much lower than the regional average of US$6,504.

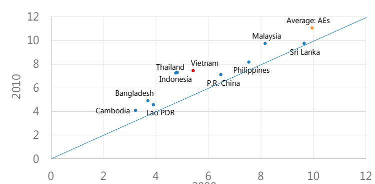
Spending outcomes vary by different spending categories. Using health life expectancy at birth (HALE) as an indicator, Vietnam ranks high versus regional peers (see chart).[1] Results of a 2010 survey on education attainment suggest that the average years of total schooling in Vietnam have increased, to above regional low-income countries, and just below more advanced regional peers. Infrastructure quality is slightly ahead of regional LICs, but below EMs in the region.

Health Life Expectancy at Birth (year, both sexes)



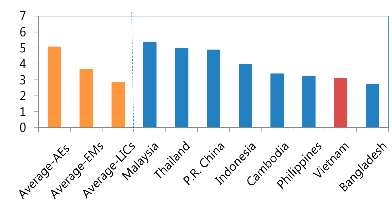
Source: World Health Organization.

Average Years of Total Schooling



Sources: Barro, Robert and Jong-Wha Lee, "A New Data Set of Educational Attainment"

Transport Quality (1-7, 2012)



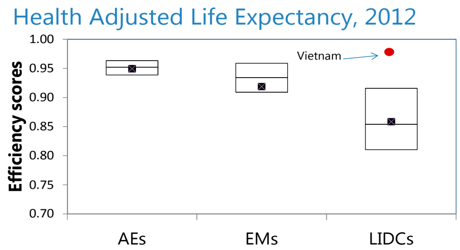
Source: World Economic Forum

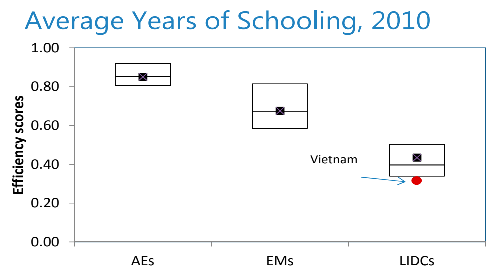
Expenditure efficiency is measured using a stochastic frontier analysis (SFA). Under SFA, a production function is estimated with individual public spending items as major explanatory variables and outcomes related to each spending item as dependent variables. The estimation provides a composite error term, which includes both an idiosyncratic error (due to random variation) and a one-sided disturbance error term. The latter measures the inefficiency of spending, and the efficiency score is thus calculated as the actual outcome divided by the estimated outcome.[2]

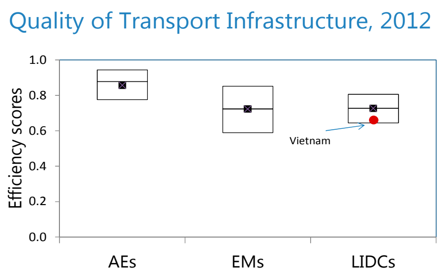
[1] Regional countries used as comparators include Bangladesh, Cambodia, China, Indonesia, Lao P.D.R., Malaysia, Philippines, Sri Lanka, and Thailand.

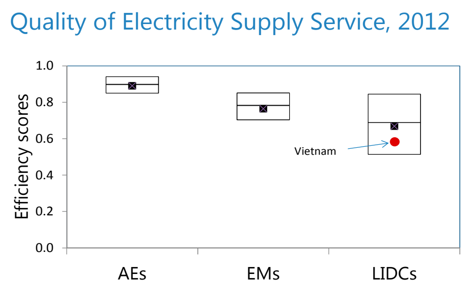
[2] Grigoli, F. and Kapsoli, J. (2013) "Waste Not, Want Not: The Efficiency of Health Expenditure in Emerging and Developing Economies", IMF working paper, WP/13/187. Results presented here are consistent with their findings.

Box 3. Vietnam: Public Spending Efficiency (concluded)









Note: The box shows the median, 25th and 75th percentiles while the black square shows the average.
A higher score indicate more efficient spending. Health adjusted life expectancy, average years of schooling, quality of transport infrastructure and electricity supply service are used to evaluate spending outcomes, while real public spending on health per capita (PPP) over 2000-2011, real public spending on education per capita (PPP) over 2000-09, and real public capital stock per capita in 2011 are used as input variables. All regressions are controlled with starting values of outcomes in the sample period.

Vietnam ranks high in health spending efficiency versus most countries. This is likely related to the government's efforts to expand health coverage in the last two decades. However, there is scope to improve. Around 60 percent of Vietnam's population is covered under social health insurance. Efforts are needed to expand coverage for the remaining population, most of whom work in the informal sector, and to improve overall financial protection by containing out-of-pocket spending.[3]

Efficiency scores show that public education spending has room to improve, although there are caveats to the results. Average years of schooling have increased, although not by as much as could have been expected given the high levels of spending. Improved vocational and practical skills are needed to reduce skills mismatches. At the same time, 2012 PISA results show the system is producing good fundamental skills.[4] More advanced skills, including critical thinking and problem solving, are also needed.[5] As the population ages and the demographic dividend subsides, Vietnam's workforce will need such skills to improve labor productivity and shift from lower to higher value added activities.

Improvements in public capital spending efficiency are needed to help narrow the infrastructure gap. Efficiency scores in public capital spending are below the average of low-income economies, using both quality of transport infrastructure and quality of electricity supply service to evaluate spending outcomes. Closer integration between strategic planning and capital budgeting, while strengthening institutions related to project implementation, would improve investment efficiency. The new public investment and enterprise laws enacted in 2014 could be a good start.

---

[3] World Bank (2014) "Vietnam: Learning from Smart Reform on the Road to Universal Health Coverage," Discussion Paper, August 2014.

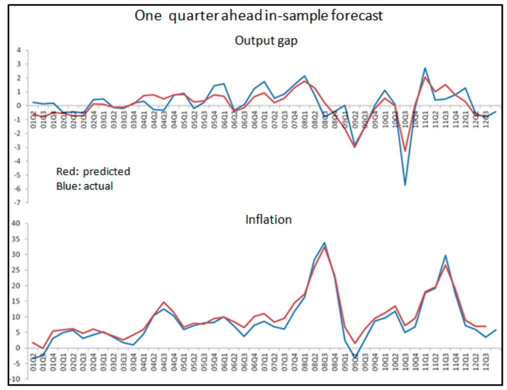
[4] PISA 2012 tests of 15-year-old students suggest Vietnam perform strongly in reading and mathematics ability.

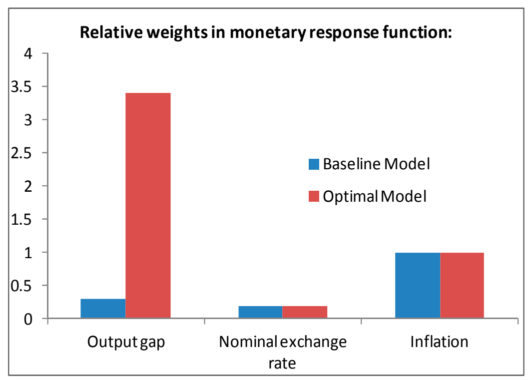
[5] World Bank (2014) "Skill up Vietnam: Preparing the Workforce for a Modern Market Economy."

Box 4. Vietnam: A Macro-Model Approach to Forecasting and Monetary Policy Analysis

Shifting to inflation as the nominal anchor for monetary policy while allowing greater exchange rate flexibility would increase macroeconomic stability.

A stochastic general equilibrium model is estimated for Vietnam to analyze different monetary and exchange rate policies through a consistent framework that formally models and clarifies transmission mechanisms, measures policy stances and allows forecasting given policy actions.[1] The model consists of four structural equations for Vietnam—an aggregate demand equation, a Phillips curve, a monetary policy rule and an exchange rate parity relation—and a block of external economies. The model is estimated using Bayesian techniques on quarterly Vietnamese data over 2000–14.





The baseline model fits actual data closely and performs well in in-sample forecasts (figure). It provides insights into structural features of the Vietnamese economy. First, the inflation process is very persistent, which implies monetary policy has to react relatively strongly and for prolonged periods to contain inflation. Second, monetary policy has little impact on food inflation, but there is a larger impact on core inflation. These results imply that the amount of output adjustment needed to control inflation is relatively large, and stresses the importance of an active monetary policy that "stays ahead of the curve" to maintain inflation stability.

An optimal monetary policy rule that jointly minimizes the variability of output, inflation, and the exchange rate is also determined. The optimal rule places a greater weight on the output gap in the reaction function than does the baseline rule. In model simulations, the optimal monetary policy function delivers greater macroeconomic stability—reduced inflation and output variability—compared to the model using the baseline reaction function, while allowing a small increase in exchange rate variability. Under the optimal rule, monetary policy is more active, and it uses the output gap as an intermediate target to achieve a greater degree of inflation stability than has been achieved in Vietnam's recent past, while allowing greater exchange rate flexibility to absorb shocks.

Standard deviations:	Baseline model	Optimal model
Output gap	1.4	0.9
Inflation	5.3	3.8
Nominal interest rate	9.6	12.4
Nominal exchange rate	2.3	2.4

[1] IMF Working Paper No. 15/273 by A. Dizioli and J. Schmittmann.

Box 5. Vietnam: Inflation as a Nominal Anchor for Monetary Policy

As Vietnam allows greater exchange rate flexibility, preparations for gradually shifting to inflation as monetary policy's nominal anchor will require upgrading operational, communications and institutional frameworks.

Maintaining low and stable inflation is key to entrench macroeconomic stability and achieve sustained improvements in the livelihood of Vietnam's population. A framework that pursues multiple objectives—real growth, inflation, the exchange rate, credit growth—is opaque, complicates policy formulation, reduces policy effectiveness, and has the potential to confuse markets, investors and consumers, particularly when these targets come under conflicting pressure. Vietnam's recent move toward more exchange-rate flexibility is a step in the right direction, and broader reforms are now needed.

Measures to strengthen monetary policy operations: Establish an interest rate corridor as an operational instrument (300 b.p. width), with the rate at the collateralized overnight credit facility as the ceiling and that of the overnight deposit facility as the floor.

- Shift the corridor to signal changes in the stance of monetary policy. Give policy decisions enough time to work as they affect prices with a lag. Adjustments should be forward looking.
- Rely upon open market operations complemented with standing facilities to implement liquidity management. Strengthen liquidity forecasting to help reduce volatility in the interbank market.
- Phase out the use of administrative measures (interest rate ceilings and credit targets) to manage liquidity, since they fuel uncertainty in the market and constrain the transmission of changes in policy interest rates to economic activity and inflation.
- Adopt the overnight interbank rate as the operational target for monetary policy. The rate should be guided to the center of the interest rate corridor using fine-tuning liquidity management operations.

Measures to strengthen communications:

- Design a communications strategy and unit. Build credibility by communicating well to help align market expectations around the SBV's primary objective of maintaining low and stable inflation as a means to achieve macroeconomic stability.
- Explain the rationale behind the SBV's framework for monetary policy. Clearly communicate the roles of inflation, exchange rate, liquidity management, the interest rate corridor, and broadly what market participants expect of the SBV's policy reaction function.
- Make the policies of SBV and its decisions more predictable for market participants to help reduce macroeconomic volatility and align variables faster around the SBV's target.

Measures to improve economic analysis, forecasting, and policy formulation:

- Improve data quality and management, including of quarterly GDP expenditure; surveys of confidence, inflation expectations, and capacity utilization.
- Strengthen current economic analysis and short-term forecasting, including use of the FPAS model. Develop a suite of analytical tools and capacity to strengthen medium-term modeling and forecasting.

Measures to strengthen the institutional framework:

- Propose a suitable inflation target over a long-term horizon to be agreed upon with the government and set low inflation as the primary policy objective in the SBV law. If the law cannot be changed, a signed agreement between the SBV and the Government should be undertaken to establish inflation stability as the SBV's primary objective.
- Over time, designate to the SBV sole responsible for policy implementation. Separate the role of Governor and that of cabinet member and use an appointment term independent from the political calendar.
- Provide for the SBV's financial autonomy, accountability and transparency, but require the SBV to disclose information and be transparent with respect to its policy decisions as well as with the management of its budget.

Box 6. Vietnam: Financial Stability Assessment

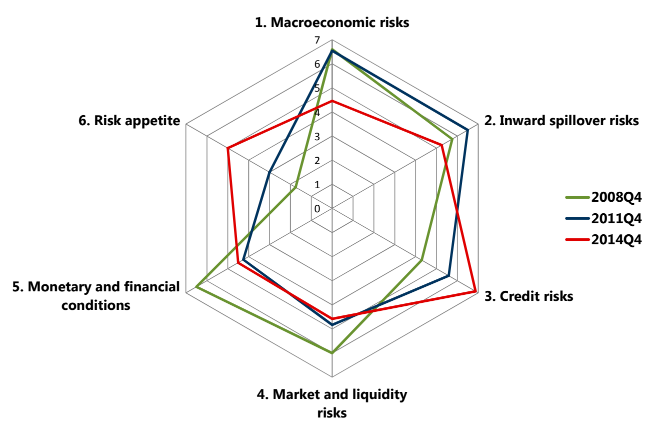
High credit risks stemming from weak corporates, undercapitalized banks and rapidly rising public debt should be addressed to safeguard financial stability.

The Financial Stability Assessment provides a framework to monitor, aggregate and put into historical context data that has been found to describe macro-financial risks.[1] Four broad risks (macroeconomic, inward spillovers, credit, and market and funding liquidity) and two conditions (monetary and financial conditions, and risk appetite) are analyzed. Indicator values are ranked relative to their own past values from 0 to 10 for every quarter, with 0 representing the lowest first percentile of risk and 10 representing the 99th percentile of risk. A ranking of 5 broadly corresponds to the long-term average. The assessment for Vietnam is customized, including by using policy choice variables rather than averages in standardizing some indicators to avoid distortions from historical outliers, and omitting some variables that have no bearing on Vietnam.

The assessment captures past risks and conditions well. Vietnam experienced two major episodes of macroeconomic and financial instability in recent years, in 2008 and 2011. The 2008 episode was preceded by very easy monetary/financial conditions and high-risk appetite and resulted in high domestic macroeconomic, credit, and banking risks. The 2011 episode followed domestic stimulus that led to a rapid credit expansion against a backdrop of already depleted policy buffers and a weak external environment. In subsequent years, the authorities' efforts to achieve macroeconomic stability, including through tighter monetary and financial conditions, led to a normalization of a number of risks.

At end-2014, macroeconomic, inward spillover, and market/liquidity risks had fallen close to historical averages and risk appetite had recovered although it remained far below levels in 2007 and early 2008. Monetary/financial conditions were close to neutral levels. In contrast, credit risk stood at a high level reflecting sovereign factors—rapidly rising public and publicly guaranteed debt and high fiscal deficits—and banking sector issues—legacy NPLs and capital shortfalls in the banking sector stemming from instability in 2008 and 2011, and a relatively weak domestic corporate sector, in particular SOEs.

Vietnam: Financial Stability Map for 2008, 2011, 2014



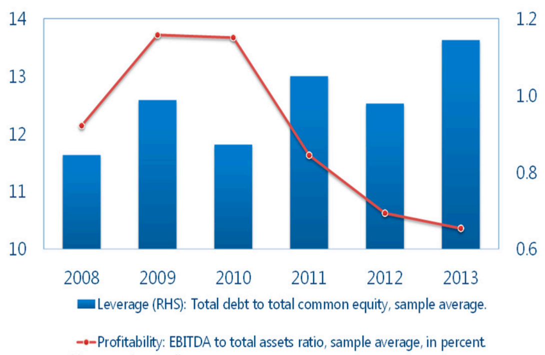
[1] Cervantes and others (2014) IMF Working Paper WP/14/99 for details on the standard approach.

Box 7. Vietnam: Corporate Debt and Implications for Bank Asset Quality

Corporate performance in Vietnam has deteriorated in recent years, particularly in SOEs, with potential for higher NPL ratios in the banking sector.[1]

Corporations' profitability has declined and leverage has increased. This combination has significantly reduced corporations' debt service capacity and is reflected in an increasing share of firms whose debt is at risk (DAR), i.e., with an interest coverage ratio (ICR) below one.[2] DAR began increasing in 2011, when profitability declined, with the sharpest increases taking place in state-owned enterprises (SOEs) (see figures).

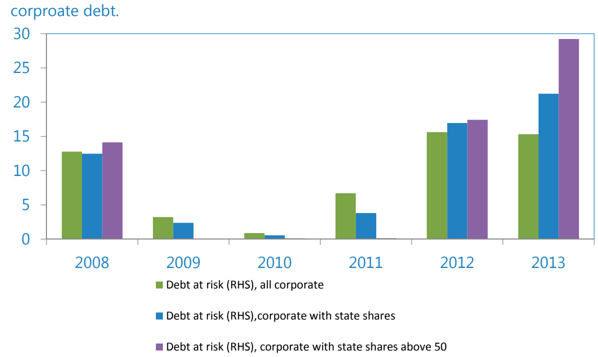
Vietnam Corporate Performance



Sources: WorldScope, and IMF staff.

Debt at Risk vs Funding cost and Earnings' Growth

Debt at Risk: total debt of corporate with ICR below 1, as percent of total corpроate debt.



Sources: WorldScope, and IMF staff.

Corporations' ability to service debt would deteriorate even further if earnings growth were to weaken, funding costs to surge, or with currency depreciation.[3] Stress tests suggest that a 200 bps increase in funding costs—possibly driven by higher interest rates in mature markets and/or a widening of emerging market spreads—would have a significant negative effect on ICR, resulting in an increase in the share of debt-at-risk of the entire corporate sector to 25 percent from 15 percent. If corporate earnings were to decline by 10 percent—possible if growth in key trading partners were to weaken—the share of debt-at-risk would increase to 19 percent. A weakening of the Vietnamese dong by 10 percent would raise the share of debt-at-risk to 22 percent.

---

[1] Corporates include only nonfinancial firms.

[2] ICR is calculated as earnings before interest and tax (EBIT) divided by total interest expense. An ICR of less than one means a firm is unable to service its debt without adjustment, such as reducing operating costs, drawing down cash reserves, or borrowing more.

[3] See *Regional Economic Outlook, Asia and Pacific, 2015*, for details on stress tests and regional performance.

Box 7. Vietnam: Corporate Debt and Implications for Bank Asset Quality (Concluded)

The banking system is exposed to potential losses from weak corporate performance. This exposure is estimated as follows.[4] First, firm-level ICRs are mapped into probabilities of default (PDs) over the two years following the base year, using historical default rates of companies with similar ICR levels compiled by Moody's. Second, the aggregate PD of corporate debt owed to banks in the sample is calculated using the average PDs weighted by the share of each firm's debt in total corporate debt. The aggregate loss rate is obtained by multiplying the aggregate PD by a 65 percent loss given default (LGD) ratio, to reflect uncertainties about collateral valuations.[5] The results suggest that NPLs for the corporate debt contained in the sample would rise to around 13 percent. This would increase those banks' NPL ratio by around 0.5 to 0.7 percentage points. If the sample results were indicative of all corporate debt owed to banks, the system-wide NPL ratio would rise by between 5 and 7 percentage points from the current official rate of just under 3 percent.[6] Provisioning against such additional NPLs would weaken the system-wide capital adequacy ratio by 3¼ and 4½ percentage points, respectively.

		No fundamental changes		with 200bps interest rate shock		with 10% negative earnings shock		with 10% currency depreciation	
		T+1	T+2	T+1	T+2	T+1	T+2	T+1	T+2
Based on sample data	Percent of total corporate debt that could default	17.0	21.3	18.3	23.5	17.3	21.9	17.45	22.09
	Bad corporate debt as share of total banks' loans to these corporates (in percent)	9.9	12.5	10.7	13.8	10.1	12.8	10.2	12.9
Implication for the entire banking sector	Resulted increases in NPL ratios (percentage points)	0.5	0.6	0.5	0.7	0.5	0.6	0.5	0.6

[4] See *Global Financial Stability Report, 2013 October,* for further details on methodology. The Vietnam analysis presented in this box uses 2013 as the base year, the last year for which data is available.

[5] Ninety percent of large corporate debt and all debt of SMEs are assumed to be bank loans, while the remaining debt is partly from official development assistance and partly corporate bonds.

[6] Corporate loans in the sample account for 5 percent of banks' total credit to the private sector. Total corporate bank loans are estimated at 50 percent of total credit to the private sector. Sources: WorldScope, State Bank of Vietnam and IMF staff.

Box 8. Vietnam: Social and Environmental Issues

Living conditions have improved dramatically in Vietnam since the 1990s. But the transformation of the economy has created new challenges such as increased inequality and youth unemployment. In addition, the country is vulnerable to climate change.

Vietnam has made remarkable progress improving living conditions and reducing poverty over the last two decades. The national poverty rate declined from 58 percent in 1993 to 13.5 percent in 2014. Progress has also been substantial in other dimensions of development, ranging from improvements in health status to reduced mortality. Vietnam has achieved, and in some cases surpassed, many of its Millennium Development Goals (MDGs). The country is ranked 116 in the Human Development Index—within the upper part of the Medium Human Development group—and performs well in gender equality where its score is above similarly developed economies.

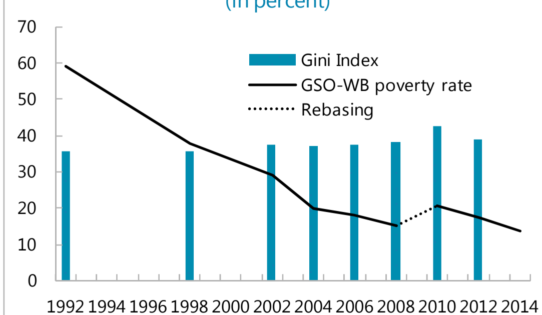
Vietnam: Key Poverty and Social Indicators

Population	90.7	millions	(2014)
Life expectancy at birth, total	76	years	(2013)
Mortality rate, under 5	22	per 1,000 live births	(2015)
GINI index	39	(0 = perfect equality)	(2012)
Income share held by lowest 20%	7	percent	(2012)
Income share held by highest 20%	46	percent	(2012)
Poverty rate	13.5	percent	(2014)
Urban	3.8	percent	(2014)
Rural	18.6	percent	(2014)
CO2 emissions	2.0	metric tons per capita	(2011)
Improved water source	97.6	percent	(2015)
Improved sanitation facilities	78.0	percent	(2015)
Human development index	0.67	(1 = maximum development)	(2014)
Rank	116	(out of 188)	(2014)
Gender inequality index	0.30	(0 = perfect equality)	(2014)
Rank	60	(out of 188)	(2014)

Sources: World Bank; and United Nations Development Programme.

While growth has been pro-poor, success has brought some challenges. Many Vietnamese households remain very close to the poverty line, and with 70 percent of the population living in rural areas, they are vulnerable to falling back into poverty as a result of idiosyncratic shocks, such as the effects of climate change on rainfall and temperatures. In addition, the remaining poor are harder to reach, reflecting factors such as isolation and limited access to education and health services. Raising their standard of living will be difficult, while their aspirations for greater prosperity and economic security grow.

Vietnam: Poverty Reduction, 1992–2014
(in percent)



Source: The World Bank.

Rapid growth has occurred without a significant increase in inequality. Inequality in incomes and opportunities was spurred by changing patterns of employment away from agriculture, and from low-skill to higher-skill jobs. The Gini coefficient rose from 36 in 1992 to 43 in 2010 (0 = perfect equality), but it eased thereafter, to 39 in 2012, comparable to that of other middle-income countries in the region.

Box 8. Vietnam: Social and Environmental Issues (Concluded)

Ethnic minority inequality is a persistent challenge. Although Vietnam's ethnic minority groups make up less than 15 percent of the population, they accounted for almost one half of the poor in 2010 (latest data), with a poverty rate at around 67 percent. Geographically, ethnic poverty is concentrated in the north-west and mid-highland regions of Vietnam.

Basic education outcomes are strong. Vietnam ranked well above most developed countries in science, mathematics and reading in the latest OECD Programme for International Student Assessment (PISA) survey of 15-year olds. This is explained in part by long-term plans and dedicated budgets for education. Education spending amounts to around 4.5 percent of GDP (22 percent of current expenditure). However, Vietnam faces challenges similar to many middle-income economies. Although primary education enrollment is high, secondary and tertiary education enrollment lags, particularly in rural areas.

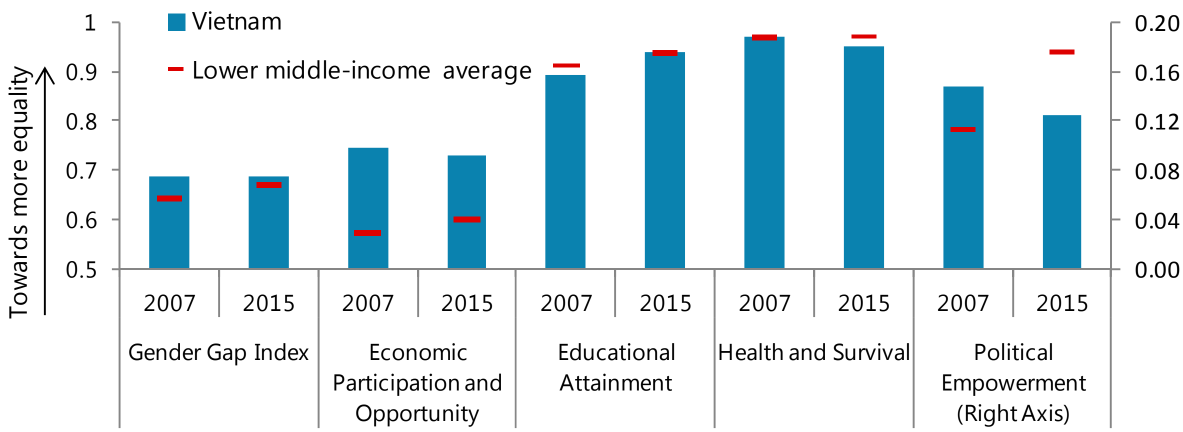
Youth unemployment is three times the overall rate. Despite strong basic education, the official unemployment rate for youths has risen to around 7¼ percent, compared to 2½ percent overall. In part this reflects skills mismatches and unmet needs for vocational and practical skills. To cope, many companies choose to train systematically most of their new employees, adding costs compared to experienced candidates. Notwithstanding, an abundance of labor and relatively low productivity has kept wages competitive relative to neighboring countries—less than half those in China in manufacturing.

According to the Germanwatch climate risk index, Vietnam was the 7th (of 181) most affected country by climatic disasters between 1994 and 2013. The index quantifies the impact of extreme weather events during the last two decades, both in terms of fatalities as well as economic losses, relative each country's income. Its population density, location and geography—a long coast line and large river deltas—combined with the significant role of agriculture in the economy exposes the country to significant climate risks. Global warming and increased extreme weather events could have major negative impacts on rice and livestock production, possibly lowering the level of output by two to four percent by 2050 (ADB estimate). The transport, energy and water sectors could also be adversely affected by storm damage to infrastructure while higher temperatures and droughts would increase demand for energy and water.

Box 9. Vietnam: Gender Equality

Vietnam made remarkable improvements on gender equality at earlier stages of development, but progress has recently decelerated. The authorities are committed and have taken measures to address the remaining inequalities, but they have yet to yield the desired results.

Gender Gap Index and Subindexes, 2007 and 2015



Source: World Economic Forum, 2015

Vietnam performs generally better than similarly developed countries on gender equality. According to the World Economic Forum's Global Gender Gap Report, it surpasses peers in measures of economic opportunity, while scores in education and health are similar to that of other lower middle-income countries. In general, Vietnam's scores have not improved significantly in the last decade, while many countries at the same stage of development have successfully established more gender equality. As a result, Vietnam has lost ground from earlier progress and slipped in the Gender Gap rankings (83rd in 2015).

Vietnamese women tend to have better access to economic opportunities compared to women in peer countries, but achievements in this sector remain mediocre. A positive development has been the sharp improvement of the female-to–male income ratio from 70 percent in 2007 to 83 percent in 2015. This represents the 19th-highest ratio, out of the 145 sample countries. However, according to a survey conducted in 2015, the perception of wage equality for similar jobs was only 60 percent.[1] In addition, the share of women in the labor force has recently decreased slightly, although it remains high at 92 percent. As a result of these factors, Vietnam's score in economic opportunity has dropped in 2015 compared to 2007.

The education gap has narrowed but is still not closed. Female primary enrollment and literacy rates are high and on a par with male rates. However, disparities are still visible in primary education completion and secondary-and-above enrolment rates. For instance, only 40 percent of PhD graduates are female. To address this issue, the Ministry of Education and Training is implementing a comprehensive renovation of the education system with the goal to ensure gender equality in curriculum and textbooks.

Box 9. Vietnam: Gender Equality (Concluded)

The women's health and survival indicator, although very close to equality, has recently fallen. In part, this is explained by a declining sex ratio at birth (0.9 female/male ratio in 2015). The two-child policy (although loosely enforced), in a context of male-favoring traditions, has possibly favored an attitude of "son preference". Additionally, adolescent fertility is rising, with around 40 births per 1,000 women aged between 15 and 19 in 2014 (against 30 in 2007), and women are vulnerable to domestic violence.[2, 3]

Women political empowerment has been subdued in the last decade and Vietnam slipped well below peers' level. The share of women in parliament has stagnated since 2007, while other countries were generally able to improve gender equality in politics. In 2007, Vietnam's share of women occupying ministerial positions was similar to the sample average, at 13 percent. In 2015, there were 9 percent of Vietnamese female ministers, while the sample average had reached 25 percent.

The authorities have made significant efforts in promoting gender equality through policy measures, but implementation and enforcement remains a challenge. In addition to gender equality guarantees in the Constitution, milestone laws include the Law of Gender Equality (2006) and the Law on Prevention and Control of Domestic Violence (2007). President Sang publicly stated Vietnam's commitment to narrowing the gender gap across all sectors, while improving access of women—especially those in disadvantaged areas—to health care, education and employment. The National Policy Framework for Gender Equality (NSGE) was approved for the period 2011–20 with the goal of highlighting the importance of gender equality for the socio-economic development of the country. However, laws have been difficult to enforce and institutions face challenges in awareness raising, reporting, gender analysis, collection of sex-disaggregated data and monitoring.

---

[1] World Economic Forum's Executive Opinion Survey, 2015. Response to the question: "In your country, for similar work, to what extent are wages for women equal to those of men?"

[2] World Bank, World Development Indicators, 2015.

[3] General Statistics Office of Vietnam, National Study on Domestic Violence against Women in Vietnam, 2010.

Appendix I. Public and External Debt Sustainability Analysis

Vietnam's public and publicly guaranteed (PPG) debt has risen by 16 percentage points of GDP in the last five years, mainly in domestic currency, to 58¼ percent of GDP in 2015. It is projected to reach around 67½ percent in 2021 while gross financing needs are forecast to remain around 10 percent of GDP over the medium term. Debt sustainability risks have climbed and Vietnam's debt is particularly vulnerable to primary balance slippage. Realization of contingent liabilities from bank restructuring could increase debt by 2½ percent of GDP, raising sustainability risk even further absent policy adjustment. These factors stress the need for fiscal consolidation to reverse the upward trend of debt accumulation. External debt is expected to increase in the short run and stabilize at moderate levels.

Background. The debt sustainability analysis (DSA) framework for market access countries is used to assess Vietnam's debt sustainability and other risks related to its funding and debt structure. The framework uses a risk-based approach and expands upon the basic DSA to include: (i) an assessment of the realism of baseline assumptions and the projected fiscal adjustment; (ii) an analysis of risks associated with the debt profile; (iii) macro-fiscal risks; (iv) a stochastic debt projection taking into account past macro-fiscal volatility; and (v) a standardized summary of risks in a heat map. This DSA also examines the implications of implementation risks by considering a no-adjustment scenario.

Coverage. The DSA is performed on the public and publicly guaranteed debt and external debt. In addition to the central government, the analysis covers State Owned Enterprises (SOEs) and Specialized Financial Institutions (SFIs), limited to the debt guaranteed by the government. Local government debt is included in the public debt.

Macro-fiscal assumptions. Using the baseline scenario, growth slows from 6.7 percent in 2015 to a projected 6.1 percent in 2016, and stabilizes at 6.2 percent thereafter. In the baseline, staff projects a primary fiscal deficit of 4.4 percent in 2016. The deficit is assumed to decline marginally over the medium-term.

Choice of framework. Vietnam's relatively high public debt and its upward trend—rising toward the 70 percent of GDP DSA threshold for emerging market economies—call for using the more detailed version (higher scrutiny) of the new DSA framework. This analysis gives a more in-depth assessment of specific risks to debt sustainability.

Realism of baseline assumptions.

- The median forecast error for real GDP growth during 2006–14 is fairly small, at -0.6 percent, showing no evidence of systematic projection bias that could undermine the assessment.
- The median forecast error for the primary balance of -1.3 percent suggests that projections have been slightly optimistic, but they remain within the interquartile range (25–75).
- GDP deflator outcomes have historically been higher than projected.

Cross-country experience suggests that the baseline fiscal adjustment is feasible. The three-year adjustment in the cyclically adjusted primary balance (CAPB) over the projected period is 1.5 percent and is assumed to be achieved mainly through expenditure reduction.

Public debt sustainability. Under the baseline scenario, Public and Publicly Guaranteed (PPG) debt is projected to increase in the short run and stabilize at around 67½ percent of GDP by 2021 breaching the government ceiling of 65 percent of GDP in 2018. Most of Vietnam's debt has medium to long-term maturity and the share of foreign currency-dominated debt is projected to decrease from 47¾ percent of total debt in 2015 to 44 percent in 2021.

The constant primary balance scenario shows that, if the deficit were to remain at the 2016 level, PPG debt would not stabilize in the medium term and reach about 74¼ percent of GDP by 2021. On the other hand, the historical scenario— in which real GDP growth, the primary balance and real interest rates are set at their historical average—leads to a decrease in PPG debt, to 62 percent of GDP in 2021. Macro-fiscal stress tests suggest that Vietnam is vulnerable to primary balance shocks. Under a scenario of a primary balance worsening in 2017–18 (by 1¼ percentage points of GDP), PPG debt would surpass the 70 percent threshold in 2021 (70½ percent of GDP). A real interest rate shock would also push PPG debt over the threshold while the impacts of the other macro-fiscal shocks are more limited.

Probability distributions from a dynamic simulation of debt sustainability under an array of macroeconomic shocks show a 25 percent chance that PPG debt could reach about 80 percent of GDP under a worst-case scenario, while a combination of positive shocks would help reduce the debt-to-GDP ratio under 55 percent with a 25 percent probability.

Heat map. The heat map shows moderate risk of debt distress. However, the gross-financing-needs-to-GDP ratio remains below the 15 percent threshold under all shocks. Finally, the assessment highlights possible risks in the Vietnam debt profile, notably in terms of market perception, external financing and foreign currency debt.

External debt sustainability. Vietnam's external debt-to-GDP ratio is expected to increase in the short run but remain at a moderate level. The main reasons for the increase are the deterioration of the current account balance and the rise of private external borrowing. External debt is estimated at about 43 percent of GDP in 2015 with gross external financing about 7 percent of GDP.

Under the baseline, external debt would stabilize at 46½ percent of GDP as gross external financing needs stabilize, in line with the projected improvement of the current account and increased FDI inflows from recently signed trade agreements (including TPP). However, Vietnam's external debt is vulnerable to real depreciation and current-account shocks. Growth and interest rate shocks have only limited impact on the external debt dynamics.

Vietnam Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	43.9	55.1	58.3	62.1	64.6	66.0	66.7	67.2	67.5
Of which: guarantees	8.7	11.0	11.5	12.1	11.1	10.1	9.1	8.3	7.5
Public gross financing needs	8.9	9.1	8.4	10.3	9.8	9.6	9.8	9.9	10.2
Public debt (in percent of potential GDP)	43.8	54.4	57.7	61.8	64.5	65.9	66.7	67.2	67.5
Real GDP growth (in percent)	6.2	6.0	6.7	6.1	6.2	6.2	6.2	6.2	6.2
Inflation (GDP deflator, in percent)	11.7	3.7	-0.2	2.4	3.1	3.6	3.8	3.8	3.9
Nominal GDP growth (in percent)	18.6	9.9	6.5	8.6	9.5	10.0	10.3	10.2	10.4
Effective interest rate (in percent) [4/]	3.7	4.6	4.8	4.6	4.6	4.6	4.5	4.4	4.3

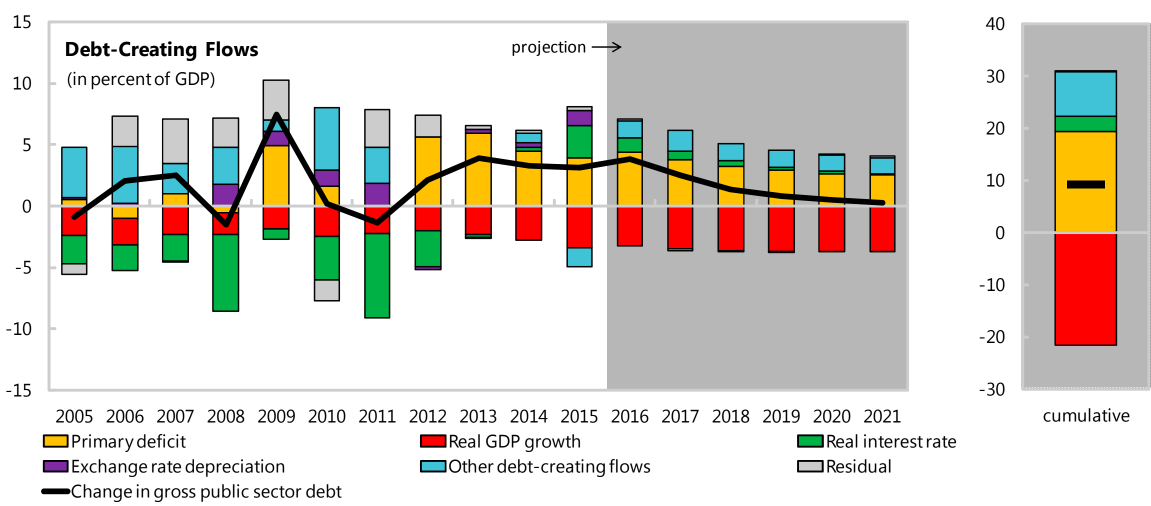
As of April 17, 2016

Sovereign Spreads	
EMBIG (bp) 3/	285
5Y CDS (bp)	241

Ratings	Foreign	Local
Moody's	B1	Ba2
S&Ps	BB-	BB
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.6	3.3	3.1	3.8	2.5	1.3	0.8	0.5	0.3	9.3	
Identified debt-creating flows	0.0	3.1	2.8	3.7	2.7	1.4	0.8	0.4	0.1	9.2	
Primary deficit	2.0	4.5	3.9	4.4	3.7	3.2	2.9	2.6	2.5	19.4	-2.4
Primary (noninterest) revenue and gra	25.4	21.9	23.7	22.9	22.8	22.8	22.6	22.3	22.2	135.6	
Primary (noninterest) expenditure	27.4	26.4	27.7	27.3	26.6	26.1	25.5	24.8	24.7	155.0	
Automatic debt dynamics [5/]	-4.5	-2.2	0.4	-2.2	-2.8	-3.2	-3.5	-3.5	-3.7	-18.8	
Interest rate/growth differential [6/]	-5.2	-2.5	-0.9	-2.2	-2.8	-3.2	-3.5	-3.5	-3.7	-18.8	
Of which: real interest rate	-3.0	0.3	2.6	1.1	0.7	0.4	0.2	0.2	0.1	2.8	
Of which: real GDP growth	-2.2	-2.8	-3.5	-3.3	-3.5	-3.6	-3.7	-3.8	-3.8	-21.7	
Exchange rate depreciation [7/]	0.7	0.3	1.3	…	…	…	…	…	…	…	
Other identified debt-creating flows	2.5	0.8	-1.5	1.4	1.7	1.4	1.4	1.3	1.3	8.6	
Fiscal- Net privatization proceeds (ne	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	1.5	1.3	1.1	1.1	1.1	1.2	7.4	
Fiscal- Net acquisition of financial as	2.5	0.8	-1.5	-0.1	0.4	0.3	0.2	0.2	0.2	1.2	
Residual, including asset changes [8/]	1.6	0.2	0.3	0.1	-0.1	-0.1	0.0	0.1	0.2	0.1	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as SOEs.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

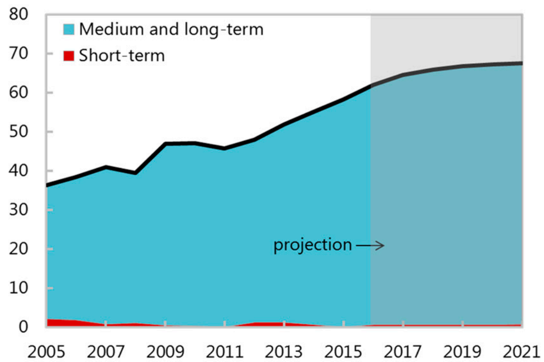
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

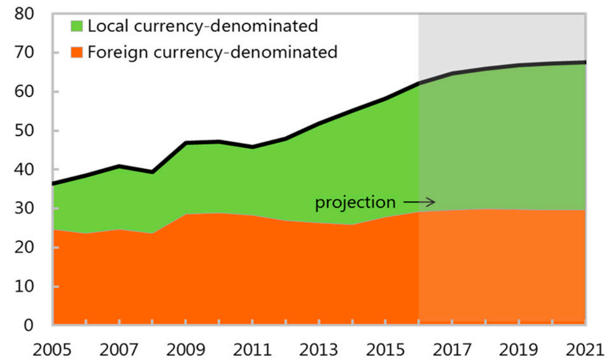
Vietnam Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



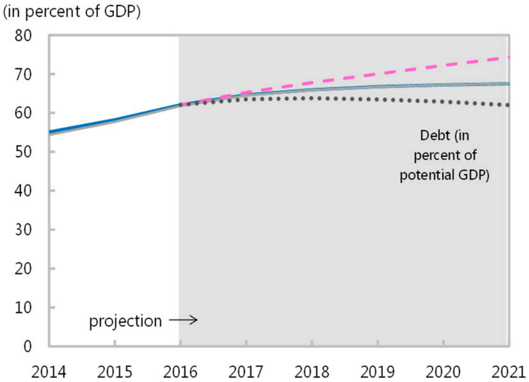
By Currency
(in percent of GDP)



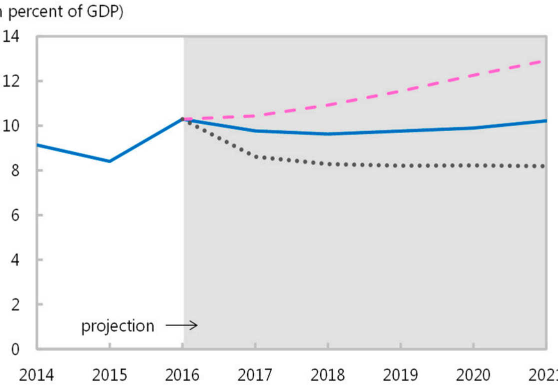
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

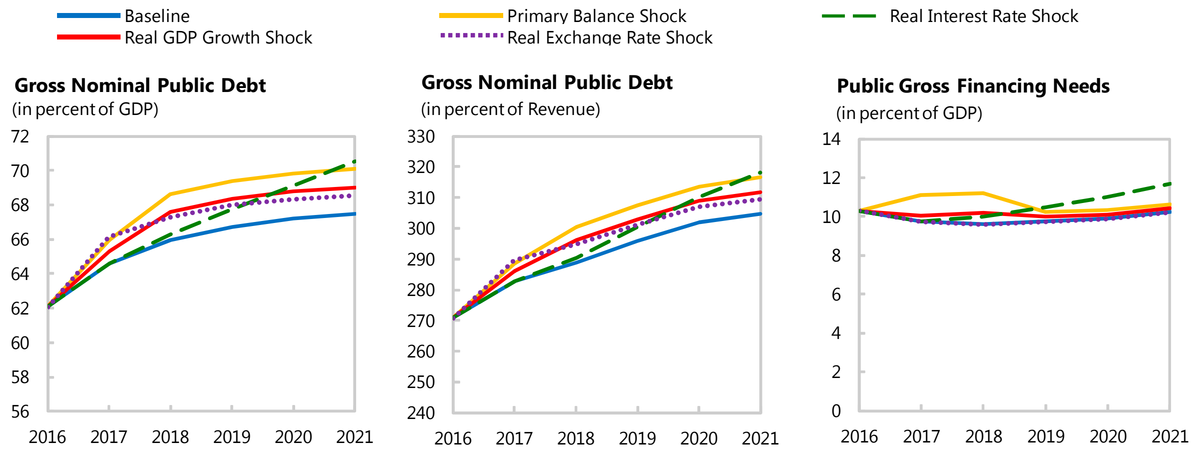
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	6.1	6.2	6.2	6.2	6.2	6.2
Inflation	2.4	3.1	3.6	3.8	3.8	3.9
Primary Balance	-4.4	-3.7	-3.2	-2.9	-2.6	-2.5
Effective interest rate	4.6	4.6	4.6	4.5	4.4	4.3
Constant Primary Balance Scenario						
Real GDP growth	6.1	6.2	6.2	6.2	6.2	6.2
Inflation	2.4	3.1	3.6	3.8	3.8	3.9
Primary Balance	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4
Effective interest rate	4.6	4.6	4.6	4.5	4.5	4.5

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	6.1	6.1	6.1	6.1	6.1	6.1
Inflation	2.4	3.1	3.6	3.8	3.8	3.9
Primary Balance	-4.4	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	4.6	4.6	3.5	2.6	1.9	1.3

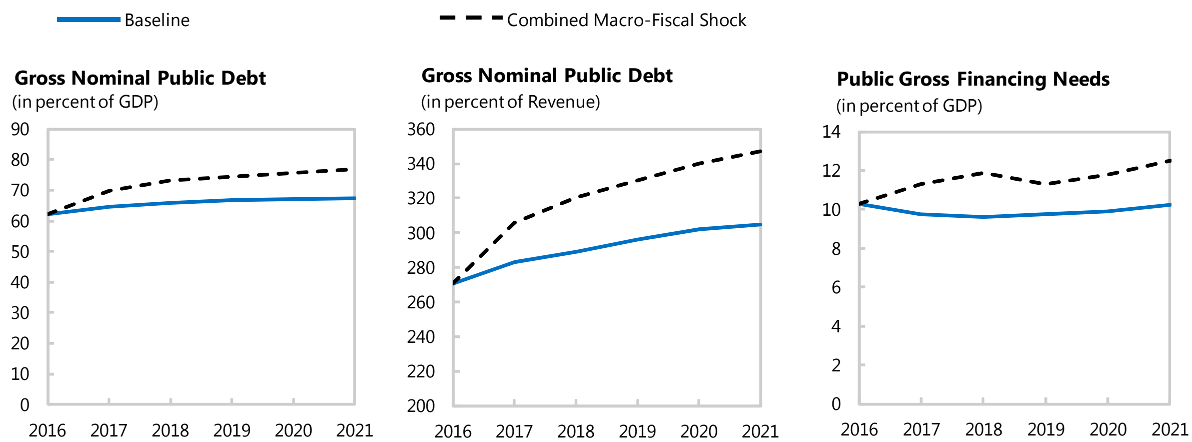
Source: IMF staff.

Vietnam Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	6.1	6.2	6.2	6.2	6.2	6.2
Inflation	2.4	3.1	3.6	3.8	3.8	3.9
Primary balance	-4.4	-5.1	-4.6	-2.9	-2.6	-2.5
Effective interest rate	4.6	4.6	4.7	4.7	4.6	4.5
Real Interest Rate Shock						
Real GDP growth	6.1	6.2	6.2	6.2	6.2	6.2
Inflation	2.4	3.1	3.6	3.8	3.8	3.9
Primary balance	-4.4	-3.7	-3.2	-2.9	-2.6	-2.5
Effective interest rate	4.6	4.6	5.3	5.8	6.2	6.5
Combined Shock						
Real GDP growth	6.1	5.5	5.5	6.2	6.2	6.2
Inflation	2.4	2.9	3.4	3.8	3.8	3.9
Primary balance	-4.4	-5.1	-4.6	-2.9	-2.6	-2.5
Effective interest rate	4.6	4.8	5.2	5.8	6.2	6.5

Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	6.1	5.5	5.5	6.2	6.2	6.2
Inflation	2.4	2.9	3.4	3.8	3.8	3.9
Primary balance	-4.4	-4.0	-3.7	-2.9	-2.6	-2.5
Effective interest rate	4.6	4.6	4.6	4.5	4.4	4.4
Real Exchange Rate Shock						
Real GDP growth	6.1	6.2	6.2	6.2	6.2	6.2
Inflation	2.4	6.2	3.6	3.8	3.8	3.9
Primary balance	-4.4	-3.7	-3.2	-2.9	-2.6	-2.5
Effective interest rate	4.6	4.8	4.5	4.4	4.4	4.3

Source: IMF staff.

Vietnam Public DSA Risk Assessment

Heat Map

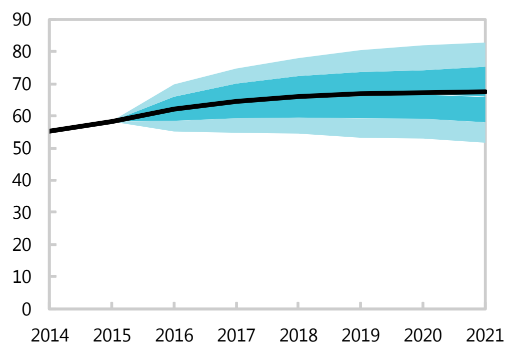
Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

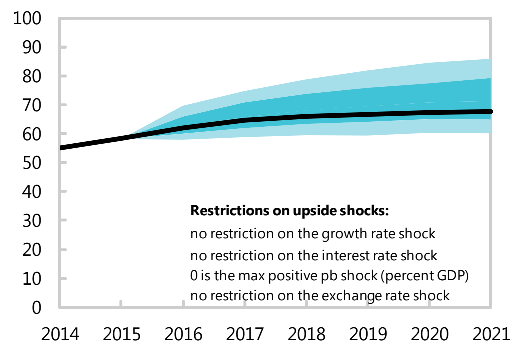
(in percent of GDP)

Baseline   Percentiles: 10th-25th   25th-75th   75th-90th

Symmetric Distribution

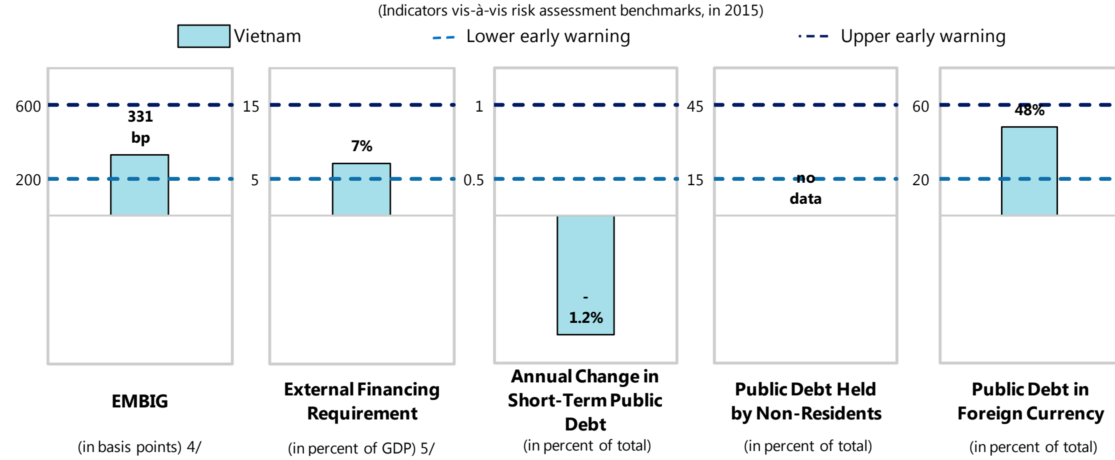


Restricted (Asymmetric) Distribution



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

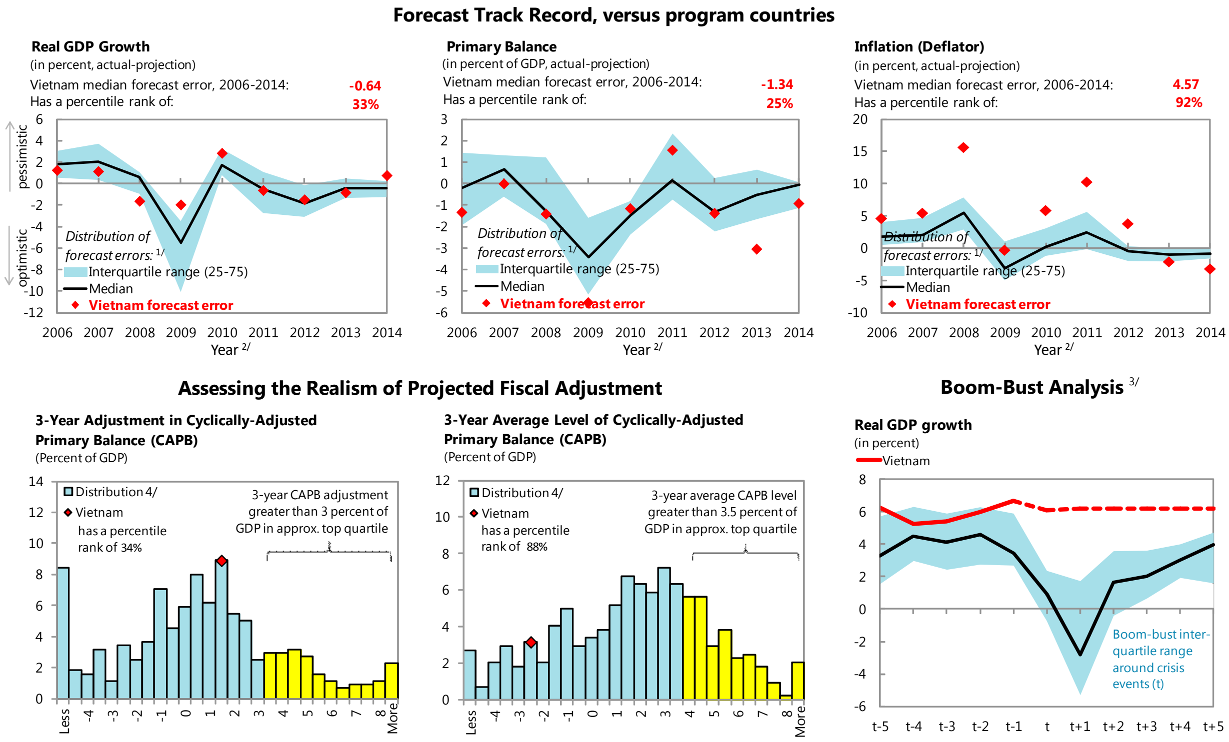
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 18-Jan-16 through 17-Apr-16.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Vietnam Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

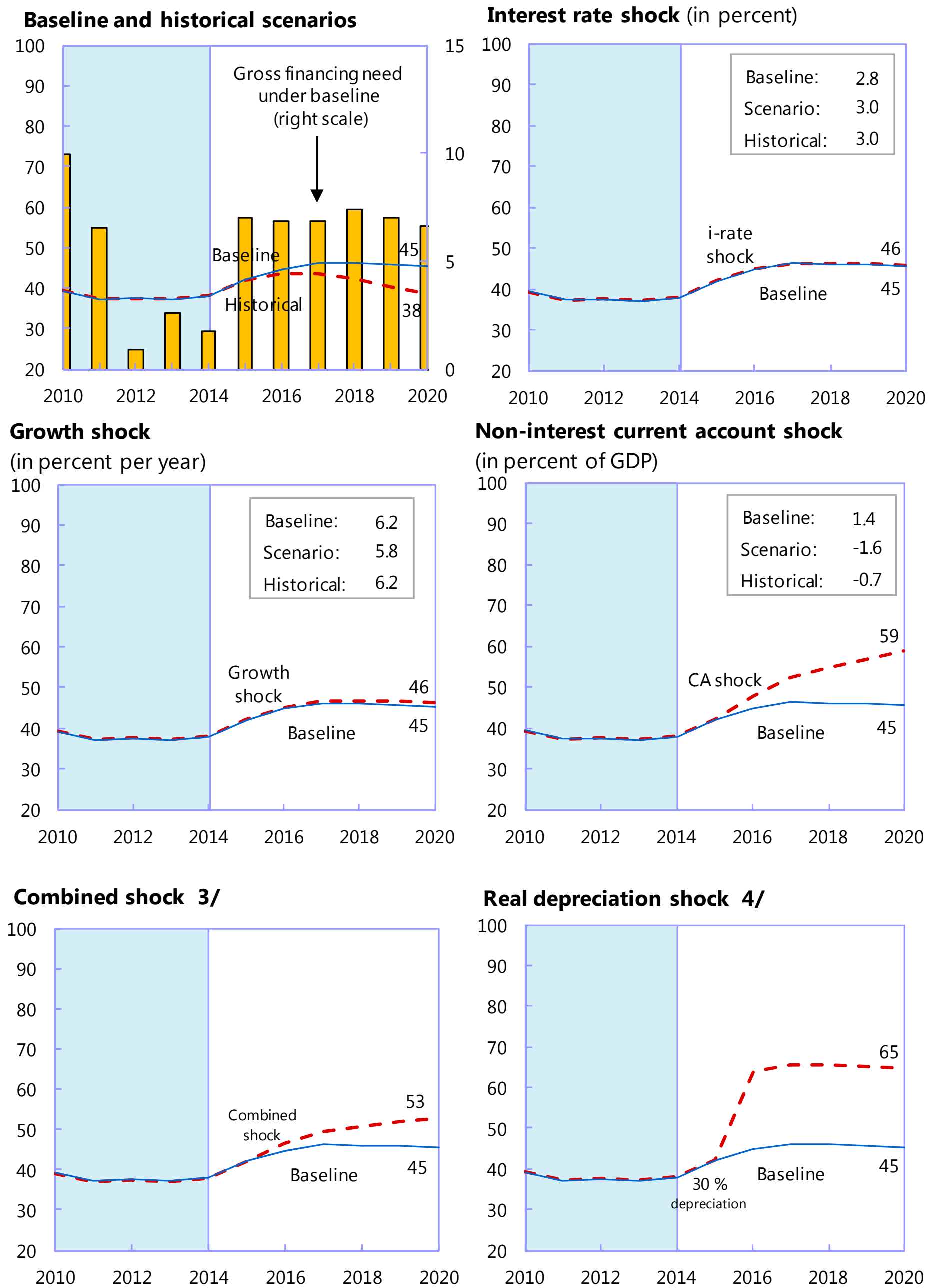
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Vietnam has had a cumulative increase in private sector credit of 17 percent of GDP, 2012-2015. For Vietnam, t corresponds to 2016; for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Vietnam: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2015.

INTERNATIONAL MONETARY FUND

VIETNAM

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 1, 2016

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of April 30, 2016)

Membership Status

Joined: September 21, 1956; Article VIII

General Resources Account

	SDR Million	Percent of Quota
Quota	1,153.10	100.00
Fund holdings of currency	1,153.10	100.00
Reserve position in Fund	0.01	0.00

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	314.79	100.00
Holdings	267.95	85.12

Outstanding Purchases and Loans: None

Latest Financial Arrangements

In millions of SDRs (mm/dd/yyyy)

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

[1] Formally PRGF.

Projected Payments to Fund

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

	Forthcoming				
	2016	2017	2018	2019	2020
Principal					
Charges/interest	0.02	0.03	0.03	0.03	0.03
Total	**0.02**	**0.03**	**0.03**	**0.03**	**0.03**

Exchange Arrangement

The exchange rate arrangement is classified as defacto stabilized. The de jure arrangement is managed floating. The State Bank of Vietnam (SBV) is gradually increasing exchange-rate flexibility. In August 2015 it widened the VND/USD trading band to +/-3 percent from +/-1 percent while devaluing the central parity by one percent. In January 2016 it announced the VND/USD rate would be adjusted daily rate based on: (i) the previous day's weighted average dong/USD exchange rate; (ii) a weighted average of movements in dong exchange rates vis-à-vis seven other important trading partners' currencies; and (iii) domestic macroeconomic conditions.

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

Article IV Consultations

Vietnam is on a 12-month consultation cycle. The last Article IV consultation was held in Hanoi during May 28–June 11, 2014, and was concluded by the Executive Board on July 30, 2014.

Technical Assistance

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

Resident Representative

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

RELATIONS AND COLLABORATION WITH THE WORLD BANK GROUP[1]

(As of April 25, 2016)

Partnership in Vietnam's Development Strategy

The current World Bank Country Partnership Strategy (CPS) for Vietnam was presented to the Board of Directors in December 2011 and adjusted through the Performance and Learning Review in March 2015. The CPS is aligned with Vietnam's Socio-Economic Development Strategy (SEDS) 2011–15 and sets out the World Bank's planned support for Vietnam between FY12 and mid-FY17. The CPS program supports investments and policies organized into a strategic framework of three pillars and three cross-cutting themes. The pillars are: (i) strengthening Vietnam's competitiveness in the regional and global economy, (ii) increasing the sustainability of its development, and (iii) broadening access to opportunity. Key cross-cutting themes are: (i) strengthening governance; (ii) supporting gender equity; and (iii) improving resilience in the face of external economic shocks, natural hazards, and the impact of climate change.

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

World Bank Group Strategy and Lending

The World Bank Group uses a broad range of instruments including development policy financing, program for results (PforR) and investment project financing, and advisory services and analytics; the IFC's equity, loan, and technical assistance (TA) participations and the Mekong Private Sector Development Facility (MPDF); and Multilateral Investment Guarantee Agency (MIGA) activities. The World Bank Group cooperates with various development partners partnerships and takes and an active role in ODA coordination.

Scale of the World Bank Group program: The WB Program is large, with a significant new IDA Allocation amounting to US$3.6 billion under IDA17. The program has grown and diversified over the past several years. As of April 20, 2016, the portfolio consisted of 45 IDA/IBRD operations and seven stand-alone Global Environment Facility (GEF), Chlorofluorocarbon (CFC), and large Recipient Executed Trust Funds (RETF) projects, with the total net commitments of US$9.0 billion. Vietnam became an IDA/IBRD blend country in FY10. So far, IBRD resources of US$2.9 billion have been used

[1] Questions may be referred to Mr. Sebastian Eckardt (+84439378232).

to finance two DPO series, an expressway, a transmission and distribution project, and a hydro-power project. International Finance Corporation (IFC) commitments totaled US$1.97 billion over the three-year period of FY14–FY16, including mobilization through its asset management business and commercial banks.

Lending program: The World Bank has a diverse lending program supporting infrastructure, rural development, human resources, and improvement in economic and financial sector management. Support to infrastructure includes energy generation, transmission and distribution; rural and national road development and inland waterways; water supply and wastewater treatment, irrigation systems rehabilitation, and natural resources management. The program also supports development of health systems to ensure increased access to quality health services and education quality improvements. The lending instrument is also diverse, with the bulk provided through investment finance and selected development policy finance operations. Key elements of economic management support include a multi-year development policy loan linked to reforms on economic management and competitiveness, tax system reform, and development and modernization of public financial management and financial systems. Since the first Program for Results operation for Vietnam was approved in support of Vietnam's Rural Water Supply and Sanitation Program in FY13, the number of PforRs have grown and two more PforR operations are currently under preparation.

Knowledge program: The World Bank supports the government's efforts to strengthen institutional capacity through its extensive program of analytical and advisory services. Especially in the context of Vietnam's transition to upper middle income status the partnership with the Bank is evolving and generating knowledge and sharing global experiences is becoming even more important. In 2014 the Government of Vietnam invited the World Bank to jointly prepare the Vietnam 2035 report which aims to identify policy reforms to achieve Vietnam's long term development aspiration of sustaining rapid growth and social inclusion. While reflecting Vietnam's remarkable development trajectory, the report identifies emerging structural constraints to the existing mostly factor driven growth model, including stagnating labor productivity growth and rising investment inefficiency. The report lays out an ambitious reform agenda structured around three pillars: (i) balancing economic prosperity with environmental sustainability, (ii) promoting equity and social inclusion and (iii) bolstering the state's capacity and accountability. Other recent reports include a study of low carbon development prospects and a public expenditure review, which examines major fiscal trends of the last decade. In addition, work is underway on Vietnam Development Report on Transforming Vietnamese Agriculture and on a Systematic Country Diagnostic which will lay the analytical foundation for identifying the Bank's priorities during the upcoming preparation of the new Country Partnership Framework (2016-21). In addition, the World Bank continues to provide technical assistance in areas such as governance, social protection, renewable energy, climate change adaptation, financial sector reform, public financial management and debt management.

IMF-World Bank Collaboration in Vietnam

Specific Areas: Since the expiration of the PRGF in April 2004, the two institutions have closely collaborated on monitoring the macroeconomic situation and routinely exchanging views on macroeconomic and fiscal management as well as key structural reforms, such as SOE and banking sector reforms. The two institutions consult during Article IV consultations in order to share information and help coordinate on key policy messages. The IMF has provided macroeconomic assessment letters in support of Economic Management and Competitiveness development policy operations. Building on joint IMF and World Bank Financial Sector Assessment Program (FSAP), which was completed during 2012–13, joint work has continued in supporting central bank operations, with the IMF providing TA on monetary policy and operations, and both the World Bank and IMF providing support on banking supervision. In the areas of fiscal management, the World Bank and the IMF are coordinating the policy dialogue on fiscal consolidation and debt sustainability, including on policy options to enhance resource mobilization and improve the efficiency of public spending. Finally, the IMF and the World Bank also collaborate in the development and timely dissemination of reliable economic and financial statistics. The IMF focuses on improving balance of payments, national accounts, price, and government finance statistics, while the World Bank provides assistance on issues related to the production of high-quality household and enterprise surveys and facilitate the implementation of National Gender Indicators System.

World Bank Lending Program FY15–16

FY	Project Name	IBRD US$ million	IDA US$ million
2015	Transmission Efficiency Project (TEP)	500.0	
2015	HCMC Env& San	250.0	200.0
2015	2nd Norther Moutain Poverty Reduction AF		100.0
2015	HCMC Green Transport Development		124.0
2015	Sustainable Agriculture Trasformation		238.0
2015	Additional Financing Livestock Competitiveness		44.7
2015	Renovation of General Education		77.0
	Total	750.0	783.7
2016	Scaling-up Sanitation Program		200.0
2016	Dam Safety Program		415.0
2016	Can Tho Urban Resilience Project	125.0	125.0
2016	Local Road/Bridges Assess Management PforR		385.0
2016	Economic Management and Competitiveness Development Policy Operation	150.0	
2016	Vinh Phuc Flood Risk and Water Management	150.0	
2016	Urban Water Supply and Wastewater AF	69.0	50.0
2016	Mekong Delta CC Res. & Sust Livelihood		310.0
2016	Program for Improved Land Governance		150.0
2016	Climate Change and Green Growth DPO		90.0
2016	Vietnam Enhancing Teacher Effectiveness		75.0
	Total	494.0	1,800.0

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of April 30, 2016)

The Asian Development Bank (ADB) has been working in partnership with the Government of Vietnam—a 1966 founding member of ADB—since the resumption of operations in 1993. ADB's Country Partnership Strategy (CPS), 2012–2015 is fully aligned with the Socio-Economic Development Plan (SEDP), 2011–2015, and supports issues arising from Vietnam's recent transition to a middle-income country. The CPS focuses ADB assistance to Vietnam through three pillars of inclusive growth, enhancing economic efficiency, and environmental sustainability. To maximize ADB's development impacts, ADB prioritizes six sectors: (i) agriculture and natural resources; (ii) education; (iii) energy; (iv) finance; (v) transport; and (vi) water supply, and other municipal infrastructure and services. Public sector management is crosscutting and mainstreamed in terms of sector operations through reform and policy-oriented support.

ADB is supporting the implementation of structural reforms that increase competitiveness and assist Vietnam in transitioning to become an upper middle-income country. This includes lending assistance and policy dialogue on financial sector and state-owned enterprise (SOE) reform issues. To increase the efficiency of public expenditure and improve the quality of infrastructure and public services ADB is also working with government to strengthen fiscal and budgetary management.

Vietnam is one of the largest concessional Asian Development Fund (ADF) recipients, with projected ADF allocation of US$733.6 million for 2015–2016. Ordinary capital resources (OCR) are also actively being used for projects with higher rates of return, such as infrastructure, which had an allocation of US$326 million in 2016 (Table 1).

From October 1993 until December 31, 2015, ADB has provided 157 sovereign loans totaling US$14.4 billion, 296 technical assistance grant projects amounting to US$276.61 million and 35 grant projects totaling US$318 million to Vietnam (Tables 2–4). As a catalyst for private investments, ADB also provides direct financial assistance to nonsovereign public sector and private sector projects in the form of direct loans, equity investments, guarantees, B loans, and trade finance. Since its inception to end-2015, ADB has approved a total of US$280 million in non-sovereign financing for Vietnam, all of which was for seven private sector projects. ADB's Trade Finance Program (TFP) fills market gaps in trade finance by providing guarantees and loans through over 200 partner banks in support of trade. The TFP has supported US$16 billion in trade involving almost 6,500 small and medium-sized enterprises. In Vietnam, the TFP works with twelve banks and has supported over US$4.7 billion in trade between 3,200 transactions by almost 2,000 small- and medium-sized enterprises. In addition to filling market gaps, the TFP's objective is to mobilize private sector capital/ involvement in developing Asia. In Vietnam, over 69 percent of the US$3.6 billion in trade supported through the TFP was co-financed by the private sector. Vietnam also receives substantial support under the Greater Mekong Sub-region initiatives, involving Cambodia, China, Lao P.D.R., Myanmar, Thailand, and Vietnam. As part of its regular operations, ADB coordinates closely with

Vietnam's development partners to improve the effectiveness, efficiency, and impact of its lending and nonlending programs. ADB also works closely with civil society organizations and the private sector in Vietnam to mobilize financial resources and expertise from other partners. ADB is an active member of the the Six Banks Initiative—comprising ADB, Agence Française de Développement (AFD), KfW, Japan International Cooperation Agency, Export Import Bank of Korea, and the World Bank. Co-financing operations enable ADB's financing partners, governments or their agencies, multilateral financing institutions, and commercial organizations, to participate in the financing of ADB projects. The additional funds are provided in the form of official loans and grants, and commercial financing, such as B loans, risk transfer arrangements, parallel loans, and co-financing for transactions under ADB's TFP. As of December 31, 2015, cumulative direct value-added official co-financing for Vietnam amounted to US$4.63 billion for 56 investment projects and US$102.9 million for 83 co-financing technical assistance projects. The ADB and IMF staffs coordinate through ad hoc information exchange information on policy matters.

Table 1. Lending (Approved Amount)* and Disbursement by Year, 1993–2015
(In millions of U.S. dollars)

	Approved amount[1/]			Disbursement
Year	Ordinary Capital Resources	Asian Development Fund	Total	Total
1993	-	262	262	0
1994	-	140	140	3
1995	-	233	233	48
1996	-	303	303	29
1997	-	360	360	149
1998	-	284	284	128
1999	40	180	220	191
2000	-	189	189	219
2001	-	243	243	176
2002	-	234	234	232
2003	-	179	179	233
2004	120	176	296	182
2005	360	218	578	224
2006	-	308	308	184
2007	924	515	1,439	230
2008	606	159	765	265
2009[2/]	1,403	523	1,926	1,093
2010	510	580	1,090	407
2011	722	365	1,086	792
2012	822	463	1,285	623
2013	410	365	775	1,226
2014	740	409	1,149	1,228
2015	738	290	1,027	899

Source: Asian Development Bank.

1/ Includes loan components of regional projects in Vietnam.
2/ Excludes a guarantee of $325 million for EVN (Loan No. 2604, approved on 12/11/09).

Table 2. Technical Assistance by Sector, December 2015

Sector	Number of Projects	In millions of U.S. Dollars	In percentage of Total
Agriculture and Natural Resources	49.0	48.4	17.50
Education	21.0	14.5	5.25
Energy	40.0	34.2	12.35
Finance	34.0	20.9	7.56
Health and Social Protection	14.0	6.9	2.50
Industry and Trade	8.0	12.6	4.56
Multi-sector	2.0	3.2	1.16
Public Sector Management	66.0	43.7	15.81
Transport and ICT	35.0	63.6	23.00
Water and Other Municipal Infrastructure and Services	27.0	28.6	10.33
Total	296.0	276.6	100.00

Source: Asian Development Bank.

Table 3. Loan by Sector, December 2015

Sector	Number of Loans	In Million of U.S. Dollars	In Percentage of Total
Agriculture and Natural Resources	28.0	1,745.2	12.1
Education	15.0	813.0	5.7
Energy	13.0	2,572.4	17.9
Finance	13.0	755.0	5.3
Health and Social Protection	8.0	343.2	2.4
Industry and Trade	6.0	159.5	1.1
Multisector	7.0	280.0	1.9
Public Sector Management	17.0	1,579.1	11.0
Transport and ICT	33.0	4,455.4	31.0
Water and Other Municipal Infrastructure and Services	17.0	1,666.7	11.6
Total	157.0	14,369.5	100.0

Source: Asian Development Bank.

Table 4. Grants by Sector, December 2015

Sector	Number of Grants	In Million of U.S. Dollars	In Percentage of Total
Agriculture and Natural Resources	11.0	57.4	18.0
Education	2.0	2.8	0.9
Energy	1.0	3.0	0.9
Finance	1.0	1.5	0.5
Health	9.0	58.6	18.4
Multi-sector	3.0	15.0	4.7
Transport and ICT	4.0	172.0	54.0
Water and Other Municipal Infrastructure and Services	4.0	8.0	2.5
Total	35.0	318.3	100.0

Source: Asian Development Bank.

STATISTICAL ISSUES

(As of May 4, 2016)

Assessment of Data Adequacy for Surveillance

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

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

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

Government finance statistics: Government operations data reflect the consolidated operations of the state budget, which cover all four levels of government (central, provincial, district, and commune). However, data exclude quasi fiscal activities of the central bank (and state-owned enterprises (SOEs)), and extra-budgetary funds, among which are the Social Security Fund, Enterprise Restructuring Fund, Development Assistance Fund, Export Support Fund, local development funds, and the Sinking Fund (for repayment of on-lent funds), for which data are not compiled/disseminated on a regular basis. Compilation is on a cash basis for final annual data, but varies for provisional data depending on their source. As a result, government financing data, in particular domestic bank financing, cannot be reconciled as reported in the fiscal and monetary accounts. The World Bank and the IMF have recommended improving the coverage of fiscal data and aligning definitions with the *GFSM 2001*. The authorities expect to provide GFSM 2001 consistent data from 2018.

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

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

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

Data Standards and Quality

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

No data ROSC are available.

Reporting to STA

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

Table of Common Indicators Required for Surveillance
(As of May 4, 2016)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	May 2016	5/2/16	D	D	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Dec. 2015	3/20/16	M	I	N/A
Reserve/Base Money	Dec. 2015	3/20/16	M	I	N/A
Broad Money	Dec. 2015	3/20/16	M	I	N/A
Central Bank Balance Sheet	Dec. 2015	3/20/16	M	I	N/A
Consolidated Balance Sheet of the Banking System	Dec. 2015	3/20/16	M	I	N/A
Interest Rates[3]	May 2016	3/20/16	D	D	N/A
Consumer Price Index	Mar. 2016	3/30/16	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	Dec. 2015	Mar. 2015	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Dec. 2015	Mar. 2015	A	A	A
External Current Account Balance	Q4 2015	2/23/15	Q	Q	Q
Exports and Imports of Goods and Services[7]	Feb. 2015	3/24/15	M	M	M
GDP/GNP	Q1 2016	3/28/15	Q	Q	Q
Gross External Debt	2015	Apr. 2016	A	A	A
International Investment Position[8]	...	...	N/A	N/A	N/A

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

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

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

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

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

[6]Including currency and maturity composition.

[7]Services data available on an annual basis.

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

Statement by the Staff Representative on Vietnam
June 10, 2016

1. This statement provides information that has become available since the staff report (SM/16/124) was circulated to the Executive Board on June 3, 2016. This information does not alter the thrust of the staff appraisal.

2. The State Bank of Vietnam announced a tightening of macroprudential policy. The risk weight for real estate loans will be increased at the beginning of 2017 and the prudential ratio governing maturity mismatches for lending will be tightened in two steps at the beginning of 2017 and 2018. The loan-to-deposit ratio limit for state-owned banks remains unchanged.

3. Monetary conditions have eased. The overnight interbank interest rate has declined well below the policy repo rate of 5 percent. Credit growth increased further in March to 19.9 percent (y/y). The exchange rate has remained relatively stable with small variations in the daily central rate.

4. Headline inflation increased to 2.3 percent (y/y) in May, reflecting higher food, energy, and administered health care prices. Core inflation edged up very slightly to 1.9 percent (y/y).

5. The trade balance registered a surplus of US$5.7 billion in the first five months of the year, reflecting a weakening of imports amid a leveling-off of export growth. Foreign direct investment inflows remain robust. International reserves increased to US$33.9 billion in April.

Statement by Mr. Marzunisham Omar, Executive Director
and Ms. Pornvipa Tangcharoenmonkong, Alternate Executive Director on Vietnam
June 17, 2016

1. Our authorities appreciate the continued engagement with the Fund and thank the mission team for the constructive and candid policy discussions during Vietnam's Article IV mission. The discussions centered on policies conducive for the next phase of reforms to achieve Vietnam's full growth potential.

2. The authorities welcome staff's recognition of Vietnam's significant economic progress and reiterated their commitment to sound macroeconomic policies and structural reforms. Macroeconomic policy has focused on preserving macroeconomic stability, whilst achieving strong economic growth that would improve the standard of living of the Vietnamese population. As acknowledged in the report, Vietnam has experienced solid growth with low inflation in recent years and has made excellent progress in achieving the Millennium Development Goals, such as poverty eradication, universal primary education and gender equality.

3. Despite the encouraging developments, the authorities are mindful of the need to address domestic and external risks and emerging challenges, including legacy risks and widening imbalances. The authorities are therefore fully committed to continue pursuing fiscal prudence, sound monetary management and financial stability, while intensifying structural reforms to maintain macroeconomic stability and sustain strong growth. The authorities broadly concur with staff assessment and agree with many of the recommendations put forward in the report.

Recent Economic Developments and Outlook

4. Prudent macroeconomic management has been key to Vietnam's macroeconomic stability and strong economic performance over the years. Despite significant uncertainties and headwinds, Vietnam is able to maintain overall economic stability and sound fundamentals. Economic growth was robust last year with real GDP growth of 6.7 percent, supported by sound macrofinancial policy settings and strong domestic demand. In the first quarter of this year, growth moderated to 5.5 percent, due to severe drought and land salinization as well as a slowdown in industrial production following slower global trade. However, the authorities remain cautiously optimistic of achieving the growth target of 6.7 percent in 2016. The new government is committed to accelerate reforms as part of the medium-term socio-economic plan and believes its strong policy efforts would improve productivity and business sentiment. This, together with reform outcomes that have started to materialize, will help achieve the 2016 growth target.

5. Although the near-term outlook is broadly positive, there remain challenges from both external and domestic fronts. Downside risks on the domestic front include deeper impact of drought and land salinization on agricultural production, inadequate fiscal consolidation and

prolonged non-performing loan (NPL) resolution. These domestic risks could be exacerbated by external shocks, including more volatile global financial conditions that could lead to capital outflows and higher domestic interest rates; weak global growth prospects and changes in the structure of global trade which could undermine exports; and persistently lower oil prices.

6. Global developments are being closely monitored and policies are formulated to reap the benefits from future opportunities and counter unexpected shocks. Vietnam has made significant progress in promoting finished-goods exports, which continue to benefit from China's rebalancing. The new flexible exchange-rate regime has been effective in acting as a shock absorber against external shocks, safeguarding macroeconomic stability and allowing an increase in international reserves. The authorities also see merit in accelerating the implementation of the Trans-Pacific Partnership and other regional and bilateral trade agreements as they would help to improve domestic productivity, support export market expansion and facilitate structural reforms.

Fiscal Policy

7. Fiscal consolidation is a critical element in the authorities' effort to improve the resilience of the economy. This is especially in view of the declining trend of revenue as a share of GDP and the increasing public and publicly-guaranteed (PPG) debt. The Ministry of Finance is developing a Medium-term Budget and Finance Plan (MBFP) for 2016-2020 for submission to the government and subsequently, to the National Assembly for approval in October 2016. The Plan will provide details on measures to gradually reduce the fiscal deficit to an average of 4 percent of GDP for the period and to 3 percent of GDP by the year 2020. At the same time, the aim is to keep the PPG debt below 65 percent of GDP.

8. The authorities note staff's medium-term growth-friendly consolidation scenario and would take careful consideration of staff's recommendations. The authorities recognize that in the absence of effective revenue enhancing measures, the burden of fiscal adjustment will be borne mainly by capital expenditures, which could undermine future growth. They concur with staff's analysis of the challenges in achieving the targets of reducing deficit and PPG debt, including reduction of tariffs and tax exemption owing to trade agreements and lower non-tax revenue from dividend because of SOEs equitization.

9. In recent years, fiscal policy has been expansionary, focusing on cushioning the impact of moderate global growth, enhancing competitiveness, attracting investment, and removing obstacles for businesses. To support economic activity, Vietnam has implemented some tax exemptions, deferral and reduction in some taxes and fees, and some other revenue measures. While these measures may seem to directly reduce revenue, the authorities consider such negative effects on revenue to be negligible, as these measures have helped stabilize the economy by smoothening consumption, attracting new investments, supporting businesses, and thus creating conditions to raise revenue in the medium term.

10. Despite unfavorable external conditions, the revenue from domestic activities has been increasing, averaging 13.1 percent of GDP during 2006 - 2010, and 14.1 percent during 2011 - 2015. In addition, the revenue structure has shifted positively, with rising share of domestic

revenue to total revenue, from 52.3 percent during 2001 - 2005 to 68 percent during 2011 - 2015. In 2015, this share was 74 percent and is expected to be higher than 80 percent during 2016 - 2020.

11. The authorities concur with staff on the need to arrest the rise in PPG debt. While staff estimates PPG debt to increase to 62 percent of GDP in 2016 and to 70 percent in the medium term, the authorities have a more optimistic view. They emphasize their commitment to maintain PPG debt below the legal limit of 65 percent of GDP and view that the risk of debt distress as being under control. The MBFP for 2016-2020 contains necessary measures to ensure the PPG debt ratio remains below 65 percent of GDP.

12. The authorities broadly concur with staff's recommendation on policies to enhance revenue and improve efficiency of expenditure. The authorities are currently formulating policies to raise revenue and are optimistic that these revenue enhancement measures will be implemented starting next year, thus contributing to narrowing the fiscal deficit. These include simplification of tax procedures and amendments to corporate income tax incentives to bring it in line with international practice. The plan is also to broaden the personal income tax base, adjust the tax rates as well as reduce the number of goods and services exempt from VAT and the number of goods and services subject to the 5 percent taxable group, with the ultimate aim of eliminating this group and applying a common VAT rate. They also plan to increase excise tax coverage, and adjust environmental protection tax rates, while the introduction of property tax is under study. On the expenditure side, the focus is to lower the current expenditure by reducing the public sector wage bill, promoting financial autonomy in public sector and increasing participation of non-state agents in delivering public services, especially in education and healthcare. In addition, efforts are underway to rationalize public investment expenditure and improve the efficiency of public investment projects. The authorities are planning to request Fund's technical assistance on tax policy with a focus on revenue strengthening measures.

13. While the authorities see the merit in enhancing financial capability of state-owned commercial banks and resolution of NPLs, the inclusion of bank recapitalization funds in the fiscal consolidation process is difficult and need to be thoroughly considered. The authorities note staff's recommendation to use budget resources upfront for banking sector recapitalization needs and the potential benefits of doing so. Nevertheless, the estimated amount of 2½ percent of GDP for banks' recapitalization needs to be carefully calibrated and a roadmap for bank recapitalization will need to be established and approved by the authorities before implementation. The total cost should be within the capacity of the budget and consistent with the plan to lower the fiscal deficit and keep PPG debt below 65 percent.

Monetary Policy and Foreign Exchange Management

14. The State Bank of Vietnam's (SBV) monetary policy stance in 2016 is to support the government's objective of maintaining macroeconomic stability, achieving economic growth target, keeping inflation rate below 5 percent and ensuring the resilience of the banking system. The SBV will continue to coordinate monetary policy closely with fiscal policy and other macroeconomic policies. The SBV will stand ready to tighten monetary policy should

inflationary pressures arise. On the other hand, if growth is slowing further and underlying inflation stalls, the SBV may consider monetary policy easing. On staff's recommendation to establish an interest-rate corridor as a channel for policy transmission, the SBV is undertaking further research on this and would implement it as conditions warrant.

15. The SBV views the 2016 credit growth rate target of 18 - 20 percent as appropriate, given the growth projection of 6.7 percent in 2016, and is consistent with the target of keeping inflation below 5 percent. However, this credit growth target may be adjusted in line with actual developments and that achieving this target will not be at the expense of credit quality as the authorities remain committed to ensuring that NPLs remain below 3 percent of total loans. Recently, the SBV issued an instruction to banks to prioritize credit for the productive sectors, such as manufacturing, agriculture and export. Credit to real estate and other potentially risky sectors is being closely monitored. That said, Vietnam's high creditto-GDP ratio reflects its bank-based economy, with businesses depending mostly on bank lending given the relatively underdeveloped capital markets. The authorities view that the use of these administrative measures are still necessary under the current conditions in order to maintain control over excessive credit growth.

16. The authorities are encouraged by staff's acknowledgement of their efforts to adopt a more flexible exchange rate regime and agree with staff's recommendation to allow for more flexibility, in response to heightened global financial volatility. Being a highly open economy, greater exchange rate flexibility provides a necessary buffer for Vietnam to withstand external shocks. Following the adoption of a more flexible exchange rate regime, in the first few months of 2016, speculative activity moderated sharply contributing to ample foreign currency supply and hence, a stabilization of the exchange rate and rebuilding of international reserves.

17. In the authorities' view, shifting the monetary policy framework toward using inflation as the nominal anchor is appropriate but requires thorough preparation and is conditional on initial settings. This includes consideration of financial market development and strength of monetary operation and liquidity forecasting capability of the SBV. The current monetary policy framework already aims at controlling inflation as a primary objective, which in turn, contributes to maintaining macroeconomic stability and sustainable growth. The SBV continues to review and assess potential enhancements to its monetary policy framework and will take staff's recommendation into consideration with a view to enhance monetary policy efficiency and will seek Fund's technical assistance if necessary.

Macroprudential and Banking Policy

18. Progress has been made in developing the macroprudential framework and a number of steps on banking sector reform have been taken. With proposed macroprudential tightening measures, tightening of regulations on lending and dividend payments at weak banks, and strengthening supervision, the authorities anticipate that they will be able to mitigate potential systematic risks. Recently, the SBV issued a circular regulating prudential ratios for the operations of credit institutions and foreign bank branches. Accordingly, the risk index of receivable lending for real estate will be raised from 150 percent to 200 percent, effective January 2017. The new circular also specifies a roadmap to reduce the maximum ratio of short-

term funds used for medium and long term loans from 60 percent currently to 50 percent in January 2017 and to 40 percent in January 2018.

19. The issue of high level of impaired loans still lingers, which poses the challenge of weak profitability of banking sector. In response, the Vietnam Asset Management Corporation (VAMC) has been established. The authorities have a plan to increase the capital of the VAMC. In March 2016, the authorities have amended the Decree on establishment, organization and operation of the VAMC, which provided legal basis to buy and sell NPLs at market value. The detailed plan of this operation was elaborated in Decision No. 618 of the SBV in April 2016, which would improve resolution incentives for VAMC's operation.

20. The authorities welcome staff's recommendation to tighten macroprudential policies, but stress the importance of appropriate timing and necessary conditions. While the authorities share staff's view on key elements, including accelerated NPLs loss recognition and resolution in banks and at the VAMC, they are of the view that using budget resources to recapitalize state-owned commercial banks and enhancing equitization of these banks require careful consideration. To further strengthen financial stability, the authorities are finalizing a macroprudential framework and improving systemic risk supervision.

Structural Reforms

21. The authorities broadly agree with staff's policy recommendations to intensify the pace of structural reforms. The new government is committed to implementing its policy agenda without delay and reaffirmed the increasing use of market-based mechanism for economic reform. As such, a number of reform measures are underway to facilitate structural adjustment and improve the business environment. In May 2016, the government issued a Resolution on Supporting and Developing Enterprises by 2020 to develop and improve economic institutions and create a business investment environment conducive to business growth as a driving force of the economy. The Resolution outlines administrative reforms and specific tasks of each ministry and government agency, aimed at creating a favorable environment to support start-ups and innovative enterprises, ensuring the right to do business, equal right to access resources and business opportunities of enterprises, reduction in business costs, and protection of the legitimate rights and interests of enterprises.

22. The authorities recognize the importance of boosting productivity and longer-term growth potential. To that end, structural reform is necessary to strengthen the spillover of productivity gains in the foreign-invested sector to the domestic economy, which can be achieved by improving the integration between foreign-invested sector and domestic suppliers. In particular, strengthening domestic-sector competitiveness would facilitate such productivity spillovers from foreign-invested sector.

23. SOE reform will be accelerated in the 2016-20 period, including greater transparency and disclosure, accelerated equitization, and improved inter-agency coordination. Good progress has been made in developing the legal framework for SOE reform, including strengthened supervisory capacity. SOEs are subject to regulations on supervision and State capital management, besides being subject to the Enterprises Law like all other enterprises. As

regard to SOE equitization proceeds and their use, the authorities see the mechanism as transparent as the Ministry of Finance is required to report regularly to the government and are subject to established regulatory framework.

24. The effects of an aging population could negatively impact growth via its implications on productivity and fiscal burden. As the share of Vietnam's working-age population to the overall population has already started to decline, the authorities concur with staff's analysis and will work on policy measures to increase labor mobility appropriately and undertake further measures to enhance productivity.

Conclusion

25. The authorities will continue to pursue sound macroeconomic policies which have supported economic growth and stability. The Vietnamese economy's strong fundamentals, together with commitment to prudent policies, will provide solid foundation to meet future challenges, with the country's long-term potential and competitiveness to be further enhanced by the steadfast implementation of structural reforms. The degree of these reforms and their implementation will be appropriately paced to achieve the desired outcomes while minimizing unintended consequences.

26. Finally, the authorities appreciate the ongoing Fund advice and technical assistance, and look forward to continued support by the Fund in their reform endeavors.