Country Report

Vietnam

August 2010

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Economist Intelligence Unit

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Executive summary

Highlights

August 2010

Outlook for 2010-11

- The Communist Party of Vietnam's 11th national congress, which is due in January 2011, is expected to usher in a new generation of leaders and so will set the tone for the policy agenda during the next five to ten years.
- The government will continue to give off mixed signals regarding the direction of fiscal and monetary policy, as it struggles to contain inflationary pressures while also trying to achieve lofty economic growth targets.
- The policy mainstay of the State Bank of Vietnam (the central bank) will be to ensure that the cost of financing does not undermine economic growth. To this end, it may move to loosen monetary policy in the short term.
- Real GDP growth is expected to reach 6.4% in 2010 and 6.9% in 2011, with the recovery in the global economy boding well for the country's export sector.
- Consumer price inflation will accelerate to an annual average of 9% in 2010-11. Global fuel prices will rise on an annual average basis in 2010, and demand-side pressures will also push up the general price level.
- Although downward pressure on the dong has diminished in recent months, policymakers are likely to face an ongoing battle to keep the local currency's exchange rate against the US dollar stable.

Monthly review

- In July the US offered Vietnam valuable support in the latter's territorial dispute with China in the South China Sea, but also slapped Vietnam's wrist over its deteriorating human rights record.
- The state-owned Vietnam Shipbuilding Industry Corporation (Vinashin) has run into severe financial trouble, after a period of aggressive expansion. It is to be broken up, with some units being taken over by other state-owned firms.
- In addition to the obvious issue of the dangers of overexpansion into non-core sectors, the Vinashin case also highlights the relative immaturity of the financial services industry in Vietnam, and in particular its audit system.
- A US-based credit-rating agency, Fitch, has downgraded Vietnam’s sovereign debt rating, citing concerns over contradictory economic policymaking, the banking sector and the level of foreign-exchange reserves.
- Foreign and local businesses in Vietnam continue to be alarmed by the sometimes erratic supply of electricity.
- Consumer price inflation slowed slightly in July, to 8.2% year on year, from 8.7% in June.
- The trade deficit continued to widen in July on the back of weaker export figures compared with June and still buoyant growth in the value of imports.

Outlook for 2010-11

Political outlook

Domestic politics

Leading members of the ruling Communist Party of Vietnam (CPV) are showing signs of nervousness ahead of the party's next national congress, with hardliners (who appear to be in the ascendant) promoting a tougher line in terms of tackling dissent. The 11th party congress, which is due to take place in January 2011, is expected to usher in a new generation of leaders and so will set the tone for the CPV's social and economic policy agenda for the next five to ten years. The party's general secretary, Nong Duc Manh, is expected to be replaced, having already served two successive terms, while the president, Nguyen Minh Triet, is likely to step down citing health problems. The prime minister, Nguyen Tan Dung, could be elected for another term, but ongoing economic instability in Vietnam means that he and his reformist allies, including two deputy prime ministers, Hoang Trung Hai and Nguyen Thien Nhan, could be eclipsed by figures with conservative tendencies. Those lining up in opposition to the prime minister include the public security minister, Le Hong Anh, the CPV's head of personnel and organisation, Ho Duc Viet, and the head of the party secretariat, Truong Tan Sang. There will be much jockeying for position within the leadership in the coming months, but it will be largely invisible from outside the party.

The CPV's success in promoting economic growth, even during the global downturn in 2009, has contributed to a sense of political apathy and has enabled the party to maintain its long-standing claim that it has the right to govern unchallenged. However, its legitimacy and its defence of the virtues of the one-party state are being questioned (mainly in Internet forums), especially in relation to economic uncertainty, pervasive corruption, environmental degradation and strongly felt grievances relating to land seizures. Reflecting such threats, the leadership will remain anxious about the activities of political dissidents and will not hesitate to suppress opposition activism. The regime's crackdown on opponents who advocate genuine democratic reform could intensify as the national party congress draws closer.

In the next few years the CPV's leaders will continue with their efforts to demonstrate a degree of political openness, but political reform that could threaten the party's hold on power will be eschewed. The National Assembly (the legislature) will continue the trend towards becoming a more effective law-making institution and shedding its rubber-stamp tag, as its deputies become increasingly assertive in calling on ministers to account for their performance and in taking the initiative in amending, or even blocking, proposed legislation and policy. The government is likely to have been embarrassed by a recent and unprecedented decision by the assembly to block a major government proposal, in the form of a US$56bn bullet-train project. However, given that nearly all assembly deputies are CPV members, there is no suggestion that the body will evolve into a genuinely independent branch of power.

International relations

Vietnam will play an important role in developments in South-east Asia this year, having taken over the revolving chair of the Association of South-East Asian Nations (ASEAN) in January. The government's stated priority during its year-long stint in the ASEAN chair is to promote co-operation within the group. Vietnam is also keen to foster closer ties with China. Although sensitive issues, such as sovereignty over disputed islands in the South China Sea, could create diplomatic tensions, on the whole Sino-Vietnamese relations will continue to become warmer. This is not likely to damage Vietnam's links with the US, as the Economist Intelligence Unit expects the Vietnamese government to continue to maintain a balance by avoiding too close an alignment with one country at the expense of ties with the other. However, relations with the US could be strained by US allegations of human rights abuses in Vietnam, and also by trade disputes.

The government is expected to devote considerable energy during the forecast period to developing Vietnam's commercial links with other countries, given that it appears eager to push ahead with free-trade agreements. Vietnamese and EU officials have agreed to begin negotiations on a free-trade deal, and Vietnam has also started talks with the aim of joining the Trans-Pacific Strategic Economic Partnership, which at present comprises the US, New Zealand, Singapore, Chile, Brunei, Australia and Peru.

Economic policy outlook

Policy trends

The government continues to give off mixed signals regarding the direction of fiscal and monetary policy, as it struggles to contain inflationary pressures while at the same time trying to achieve lofty economic growth targets. It has extended its interest rate subsidy scheme for medium- and long-term loans until the end of 2010, although it now provides a subsidy of only 2 percentage points (in 2009 the subsidy was equivalent to 4 percentage points, and also applied to short-term loans). The subsidy has helped to provide firms with working capital and has thus boosted economic activity, but there have been adverse side-effects, with the resultant rapid growth in domestic credit causing inflationary pressures to intensify. Although credit growth slowed sharply in early 2010 as the State Bank of Vietnam (SBV, the central bank) removed the cap on lending interest rates, the authorities have since put pressure on banks to lower their rates. Such apparently contradictory moves raise concerns about the lack of a clear monetary policy strategy. The authorities also appear to be considering more controversial moves, such as introducing price controls on private and foreign businesses, to keep prices stable. If implemented, such drastic measures would undermine confidence in economic management in Vietnam. They would also indicate that those in the government who favour a more liberal approach to economic policymaking have been sidelined by others with a controlling mentality who aim to expand the state's involvement in the management of the economy.

Fiscal policy

We expect the budget deficit (excluding on-lending) to narrow to 7.6% of GDP in 2010 and 6.8% in 2011, after widening to an estimated 8.9% of GDP last year. In part, this reflects our forecast that the government's revenue position will improve as economic growth accelerates and as global crude oil prices rise from the lows to which they sank in 2009 (the Vietnamese government derives substantial tax revenue and royalties from the oil and gas sector). However, expenditure will remain high as the government continues to spend relatively heavily on infrastructure and social welfare programmes; the IMF recently revealed that there was considerable uncertainty as to whether a planned reduction in investment spending would be achieved. Moreover, there are concerns about how the government will finance its deficit in the next two years, as it is already borrowing heavily to fund its off-budget economic stimulus programmes. In January the government raised US$1bn through an international sovereign bond issue, but this was at a premium, and in recent months it has struggled to sell domestic bonds, partly owing to its reluctance to meet the demand for higher yields.

Monetary policy

The SBV will continue to take a short-term view with regard to monetary policy. It will take adequate steps to adjust policy when this is made necessary by rising inflation or over-tight financing conditions, but will do so on an ad hoc basis. There will be no clear medium- or long-term policy stance on inflation or the maintenance of a stable exchange rate. The mainstay of the SBV's policy approach will be to ensure that the cost of financing does not undermine economic growth.

After raising its main policy interest rate, the prime rate, by 1 percentage point to 8% in December 2009 (having lowered it from 14% to 7% between mid-2008 and early 2009), the SBV has since kept the rate on hold. Moreover, although the central bank has removed the cap on commercial bank lending rates (which were previously limited to 1.5 times the prime rate), the government has recently called for lending rates to be cut to spur credit growth, as the scrapping of the cap led to an immediate rise in commercial bank lending rates of 2-3 percentage points. As inflation has yet to return to double-digit rates, the authorities may delay further tightening or might even loosen policy. Now that the direct link between the prime rate and commercial bank lending rates has been severed, any future tightening may come not in the form of increases in policy rates but by the use of other instruments.

Economic forecast

International assumptions

International assumptions summary
(% unless otherwise indicated)

	2008	2009	2010	2011
Real GDP growth				
World	2.8	-0.7	4.2	3.6
China	9.6	9.1	9.9	8.3
EU27	0.9	-4.2	0.8	1.1
Exchange rates				
¥:US$	103.4	93.7	92.6	93.0
US$:€	1.47	1.39	1.26	1.19
SDR:US$	0.63	0.65	0.67	0.69

International assumptions summary
(% unless otherwise indicated)

	2008	2009	2010	2011
Financial indicators				
¥ 3-month money market rate	0.85	0.38	0.20	0.31
US$ 3-month commercial paper rate	2.18	0.26	0.22	0.35
Commodity prices				
Oil (Brent; US$/b)	97.7	61.9	80.0	78.5
Gold (US$/troy oz)	871.8	973.0	1,187.3	1,242.5
Food, feedstuffs & beverages (% change in US$ terms)	28.3	-20.4	-3.4	0.0
Industrial raw materials (% change in US$ terms)	-5.1	-25.6	33.7	5.1

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

Renewed fears in late May and early June about contagion in the euro zone from Greece's debt travails, and, more generally, mixed data regarding the progress of the economic recovery around the world, have cast doubt on the sustainability of the rebound in global growth and have contributed to an increase in market volatility. A particular concern is the ability of the Chinese authorities to engineer a soft landing for China's rapidly growing economy.

Asia will be the strongest region in terms of economic growth in 2010-11, although the need to scale down the massive credit expansion in China that has been implemented in the past year could cause instability. A downturn in China would hit Vietnam's export sector, as it is the country's third-largest export market after the US and Japan. Vietnam's export sector could also face difficulties as a result of the expected slowdown in the US economy in 2011 and the ongoing sluggishness of the recovery in Europe. Although Vietnam will benefit from a rise in international demand, an increase in global prices for crude oil and industrial raw materials will contribute to rising inflationary pressures in the country, at a time when domestic price pressures are high following a prolonged period of rapid credit expansion.

Economic growth

Gross domestic product by expenditure
(D bn at constant 1994 prices where series are indicated; otherwise % change year on year)

	2008[a]	2009[b]	2010[c]	2011[c]
Private consumption	333,496	346,671	372,421	400,402
	9.2	4.0	7.4	7.5
Public consumption	32,549	35,218	38,035	41,002
	7.5	8.2	8.0	7.8
Gross fixed investment	188,647	192,420	204,350	219,063
	3.8	2.0	6.2	7.2
Final domestic demand	**554,692**	**574,309**	**614,807**	**660,467**
	7.2	3.5	7.1	7.4
Stockbuilding	27,301	32,000	31,000	29,500
	1.3[d]	1.0[d]	-0.2[d]	-0.3[d]
Total domestic demand	**581,993**	**606,309**	**645,807**	**689,967**
	8.0	4.2	6.5	6.8

Gross domestic product by expenditure

(D bn at constant 1994 prices where series are indicated; otherwise % change year on year)

	2008[a]	2009[b]	2010[c]	2011[c]
Exports of goods & services	519,439[b]	488,795	560,561	623,004
	14.8[b]	-5.9	14.7	11.1
Imports of goods & services	620,835[b]	586,053	668,873	737,399
	15.1[b]	-5.6	14.1	10.2
Foreign balance	**-101,396**[b]	**-97,257**	**-108,312**	**-114,394**
	-3.2[d]	0.8[d]	-2.1[d]	-1.1[d]
GDP	**489,833**	**516,320**[a]	**549,495**	**587,573**
	6.2	5.4[a]	6.4	6.9

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts. [d] Contribution to real GDP growth (as a percentage of real GDP in the previous year).

Growth in Vietnam's real GDP will accelerate from 5.4% in 2009, but it will not return to the heady annual rates of more than 8% that were recorded in the years preceding the 2008-09 slowdown. In the first half of 2010 year-on-year growth in real GDP was still fairly slow by Vietnamese standards, at 6.2%, and in the year as a whole it is forecast to reach 6.4%. On the positive side, the recovery in the global economy bodes well for the country's export sector, and the recent rise in imports suggests that consumer and investor demand is strengthening. On the negative side, the proactive approach taken by the government in order to keep the economy afloat in 2009, notably through fiscal and monetary loosening, is likely to prove inflationary, limiting policy flexibility in the next two years. The government will hesitate to tighten monetary policy sharply in 2010, as to do so would starve the economy of funds, putting a damper on economic activity. Moreover, rising inflation and relatively high unemployment (owing to slowing rates of job creation) could constrain future consumer spending growth.

On the supply side, growth in the industrial sector will accelerate in 2010-11. There will be an improvement in manufacturing output compared with 2009, but growth in demand for Vietnam's manufactured exports will remain lacklustre in the next two years compared with the period that preceded the 2008-09 global recession. Foreign investors remain positive about Vietnam's long-term prospects, and growth in manufacturing investment will be robust in the next two years owing to relatively high capacity utilisation rates. The construction sector has been growing rapidly, having received a boost last year from low interest rates and reduced prices for materials. The construction industry will be supported in 2010-11 by state investment in infrastructure development projects, as well as by an expansion of office space. Growth in the services sector, which functioned as the main engine of economic expansion in 2009, will also accelerate, with retailing and financial services making major contributions to growth.

Inflation

Consumer price inflation will accelerate to an annual average of 9% in 2010-11, having slowed to 7% in 2009 as a result of a drop in food and fuel prices. Global fuel prices will rise on an annual average basis in 2010, and demand-side pressures will also push up the general price level. By making credit cheaper and actively encouraging domestic banks to lend, the government has successfully boosted demand for credit. Assuming that the authorities continue to maintain a policy bias towards supporting growth rather than stabilising prices, we forecast that the outstanding stock of domestic credit will rise by an average of around 30% a year in 2010-11. The risks to our inflation forecast therefore remain on the upside.

Exchange rates

Although downward pressure on the dong has diminished in recent months, policymakers will continue to face a challenge in terms of maintaining stability in the currency's exchange rate against the US dollar. The SBV has devalued the dong twice recently, in November 2009 and February 2010, resulting in a cumulative drop of 6.4% in its value against the dollar. Until there are clear signs that the trade deficit is narrowing and inflationary pressures are receding, it is unlikely that downward pressure on the dong will cease. During the next two years the SBV may try to engineer a controlled, gradual fall in the value of the local currency, but it will probably have to opt for further devaluations, a widening of the currency's trading band or both. The dong is forecast to depreciate to an average of D19,049:US$1 in 2010 and D19,453:US$1 in 2011.

External sector

The current account will remain in deficit in 2010-11. Despite a recovery in exports, the release of pent-up demand for imports and an acceleration in consumption and investment growth will mean that the merchandise trade deficit remains worryingly large in 2010-11. The services and income accounts will also stay in the red. Capital and financial inflows (including official foreign borrowing) will meanwhile increase from the low levels to which they sank in 2009. Vietnam has already succeeded in raising US$1bn through a ten-year sovereign bond issue in January 2010, and foreign direct investment inflows are picking up. The country's international reserves position will therefore improve in 2010-11, having deteriorated sharply in 2009. However, reserves are not expected to return to their 2008 highs within the next two years.

Forecast summary
(% unless otherwise indicated)

	2008[a]	2009[a]	2010[b]	2011[b]
Real GDP growth	6.2	5.4	6.4	6.9
Industrial production growth	14.6	7.6	11.0	10.8
Gross agricultural production growth	4.4	1.8	2.0	3.0
Consumer price inflation (av)	23.1	7.0	9.0	8.9
Consumer price inflation (year-end)	21.6	6.5	10.8	6.6
Lending rate	15.8	10.4[c]	11.9	11.4
Government balance (% of GDP)	-5.4[c]	-8.9[c]	-7.6	-6.8
Exports of goods fob (US$ bn)	62.7	57.1[c]	69.9	76.9
Imports of goods fob (US$ bn)	75.5	66.9[c]	82.3	89.2
Current-account balance (US$ bn)	-10.7	-7.7[c]	-9.9	-9.4
Current-account balance (% of GDP)	-11.9	-8.3[c]	-9.7	-8.2
External debt (year-end; US$ bn)	26.2	27.8[c]	32.7	35.8
Exchange rate D:US$ (av)	16,440	17,800	19,049	19,453
Exchange rate D:¥100 (av)	15,905	18,995	20,568	20,917
Exchange rate D:€ (year-end)	24,234	26,474	23,064	23,395
Exchange rate D:SDR (year-end)	26,215	29,127	28,055	28,604

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Economist Intelligence Unit estimates.

Monthly review: August 2010

The political scene

The US speaks out on a touchy territorial issue

Vietnam's relations with the US took centre stage in July. The US offered Vietnam valuable support in the latter's territorial dispute with China in the South China Sea, but also slapped Vietnam's wrist over its deteriorating human rights record. The vocal stand that the US secretary of state, Hillary Clinton, took on the two issues at the 27-member Association of South-East Asian Nations Regional Forum in the Vietnamese capital, Hanoi, on July 23rd is likely to have partly encouraged and partly disappointed Vietnam's leaders. Mrs Clinton and her husband, a former US president, Bill Clinton, are highly regarded in Vietnam owing to Mr Clinton's decision in 1995 to restore diplomatic ties and lift the US economic blockade on the country. Mrs Clinton's remark that territorial disputes in the South China Sea should be resolved peacefully, without threats or coercion, could further endear the Clintons to the leadership of the ruling Communist Party of Vietnam (CPV).

China claims sovereignty over the entire South China Sea, and is attempting to resolve, one-by-one, its conflicts with other claimants to the Paracel and Spratly islands there. Along with Vietnam and China, the Philippines, Brunei, Malaysia and Taiwan also claim sovereignty over the Spratly Islands. Taken as a whole, the South China Sea sovereignty issue is becoming increasingly important strategically. The area is believed to contain large oil and gas reserves, and also has rich fishing grounds. In addition, it straddles some of the world's busiest shipping lanes, meaning that a violent confrontation there would present a potential threat to global trade links.

The push by the US for a multilateral solution to the South China Sea territorial disputes will be largely welcomed in Vietnam, which has a somewhat unpredictable relationship with China. Smaller nations, such as Vietnam, where distrust of China's motives runs deep, could be encouraged to band together to resist China's overtures and its rapidly growing military might. Mrs Clinton announced on July 22nd that the administration of the current US president, Barack Obama, was trying to create a formal mechanism to help resolve sovereignty disputes in the South China Sea. She stressed that it was in the national interest of the US to reach a solution to the disputes, but that the US did not favour any particular nation. However, by promoting a multilateral approach, Mrs Clinton irritated Chinese officials. China's Ministry of Foreign Affairs issued a statement criticising the US secretary of state for staging an "attack" on China. The statement claimed that the Chinese government conducts negotiations with other claimants peacefully.

Mrs Clinton's comments are broadly reflective of the growing desire of the US to re-engage with Asia, and especially South-east Asia, since the election of Mr Obama in November 2008. The US is promoting fresh economic and trade initiatives in the region, and is hoping thereby to create a trans-Pacific trading alliance in response to the deepening trade ties between China and South-east Asian countries. Vietnam is among the countries that the US hopes will join the

Trans-Pacific Strategic Economic Partnership between the US, New Zealand, Singapore, Chile, Brunei, Australia and Peru, which aims to thrash out a financial services and investment agreement.

The US criticises Vietnam on human rights

Mrs Clinton's remarks on Vietnam's record on human rights are unlikely to have been well received in the corridors of power in Vietnam. The government's recent crackdown on dissidents and its renewed efforts to clamp down on Internet-based criticism of CPV rule have caught the attention of a number of foreign governments, including that of the US. In her recent remarks Mrs Clinton unleashed some of the strongest criticism yet of Vietnam's repressive political system. She also urged Vietnam's government to consolidate the country's economic gains in recent years by opening up its political system. Mrs Clinton warned that the Vietnamese government could expect to come under further pressure from the US to guarantee human rights.

Vietnam's government has lurched towards an increasingly intolerant approach to criticism in the past year. This is partly a reflection of the changing political climate. The 11th national party congress, due in January, will set the country's political and economic direction for the next five years. It is a sensitive time in Vietnam's political arena. Hardliners are jockeying for position, and more moderate voices and reformers, including the prime minister, Nguyen Tan Dung, could face a strong challenge to their leadership. The authorities are growing increasingly cautious in the build-up to the congress, and in the past year have arrested around a dozen human rights activists, some of whom have been sentenced to lengthy prison terms.

The government has also attempted to rein in online criticism. Social-networking websites, such as Facebook, are often difficult to access in Vietnam. Owing to an apparent fear that dissidents could use the site to organise campaigns against the government, Internet service providers have allegedly been instructed to block access to Facebook. Other websites dedicated to environmental or political issues have also been blocked. Mrs Clinton's remarks were a clear indication that Vietnam's more conservative bent has not gone unnoticed in US government circles. However, her expression of concern could complicate efforts to achieve the strengthening of economic and trade ties that both sides favour.

Economic policy

Vinashin is going bankrupt and will be broken up

Troubled by persistent budget deficits and concerns about another downturn in the global economy, in July Vietnam's leaders took action to address one of the more controversial aspects of the country's rapid economic growth, namely rapid growth in Vietnam's state-owned enterprises (SOEs). The main targets are the Vietnam Shipbuilding Industry Corporation (Vinashin) and its chairman, Pham Thanh Binh. The company is on the brink of bankruptcy, following a period of aggressive expansion. On July 14th the government announced that it had suspended Mr Binh pending a police investigation into alleged wrongdoing at the firm. In recent years Vinashin has borrowed US$3bn to support its expansion into shipping and related fields outside its core shipbuilding business. It has also become involved in ventures entirely unrelated to its main activity, including a foray into the hotel market. According to the website of the Ministry of Science and Technology, Vinashin now has debts of around US$4.2bn and assets of US$4.7bn.

The problems at Vinashin are an embarrassment to the government, especially Mr Dung, as well as being a drain on the government's limited financial resources. Vietnam's leaders previously hoped that a strong, dynamic public sector would help to lead the development of the economy, with the added bonus that important industries would stay in state hands. The leadership looked to South Korea's *chaebols* (conglomerates) as their model. Seemingly narrowly focused businesses began to venture into vastly different sectors. Electricity of Vietnam (EVN, the state-owned electricity supplier), for example, moved into the mobile-phone sector, while a government-owned energy firm, PetroVietnam, planned luxury hotels and opened banks. Meanwhile, one of Vinashin's more outlandish ventures was its involvement in a beer-brewing project. However, Mr Binh frequently emphasised that Vinashin's investments often went to related, vertically connected businesses in a bid to gain control over the entire supply chain in the shipbuilding and shipping sectors.

Critics of Vietnam's policies with regard to the state-owned sector have long argued that the SOEs would grow into cumbersome conglomerates, ill-equipped to adapt to a rapidly changing economy. Some argued that this "chaebolification" programme crowded out more efficient investors and put pressure on SOEs to diversify into fields in which had neither experience nor expertise. In 2008, with inflation accelerating and global economic growth slowing sharply, the authorities tried to put the brakes on the state sector's expansion into non-core businesses. Now Vietnamese officials are breaking up what they see as one of the main offenders. A newspaper published by the Ministry of Public Security reported that 13 of Vinashin's businesses would be transferred to other SOEs, including PetroVietnam and Vietnam National Shipping Lines, by the end of September.

State media have also reported various allegations against Mr Binh, including accusations that he set up unviable units and placed a number of his relatives in charge of various business operations. The suspended chairman also allegedly submitted false reports on Vinashin's financial state. Mr Binh could face criminal charges for causing losses to the state—a serious charge that has also been levelled at other executives who have fallen foul of the authorities in the past. This is a significant issue for investors in Vietnam, as those deemed responsible for the loss of state money—even indirectly or inadvertently—face prosecution and possibly jail if found guilty.

In addition to the obvious problem of overexpansion into non-core activities and the seriousness of the legal implications of losing state money, the Vinashin case also highlights the relative immaturity of the financial services industry in Vietnam, and in particular of its audit system. At least some of Vinashin's financial problems, and its chairman's alleged wrongdoings, would have been flagged up earlier had proper auditing procedures been in place. According to the State Audit of Vietnam, which is responsible for auditing state-owned firms, Vinashin had not been audited since 2006. Moreover, the case also points to the inherent problems associated with state-directed lending. Vinashin was able to obtain access to huge amounts of capital in order to expand into new business areas, and it is unclear how rigorous was the risk-assessment process conducted by the lenders.

Vietnam's credit rating is downgraded by Fitch

On July 28th a US-based credit-rating agency, Fitch Ratings, downgraded Vietnam's sovereign debt rating, citing concerns about contradictory economic policymaking, the health of the country's banking sector and the level of foreign-exchange reserves. Vietnam's long-term and local-currency ratings were downgraded to B+, four notches below investment grade, from BB- previously. The director of the Asia Sovereign team at Fitch, Ai Ling Ngiam, said that the country's creditworthiness had deteriorated "on the back of weaker external finances and rising external financing requirements amid an inconsistent macroeconomic policy framework". With regard to the latter, Vietnam's policy-makers have been performing a balancing act over the past year. On the one hand, the authorities have been keen to pump money into the economy to promote economic growth, while on the other, they have shown concern over the need to keep inflationary pressures under control and maintain a stable exchange rate. These policy objectives are not always compatible and leave the economy vulnerable to economic and financial shocks.

Vietnamese officials face a troublesome situation in which foreign-exchange reserves have fallen to a precariously low level, the current and fiscal accounts are in deficit and inflation remains relatively high. This leaves the economy, and particularly the exchange rate of the dong against the US dollar, vulnerable to changes in investor risk appetite. In addition, the willingness of Vietnamese to hold dong is also influenced by the perceived stability or instability of the currency—the country's residents tend to dump the local currency in favour of gold and US dollars when inflation rises and downward pressure on the dong increases. According to the latest available data from the IMF, foreign-exchange reserves fell to just US$13.8bn in March, before subsequently showing a marginal improvement. The March level was equivalent to seven weeks of imports, compared with just under 2.5 months at the end of 2009. The country's relatively meagre reserves mean that it will not be able to support the exchange rate if there is a renewed episode of strong downward pressure on the dong.

The short-term impact of the ratings downgrade will be limited by the fact that there are reportedly no plans for new sovereign debt issues. Nevertheless, Fitch's ratings move threatens to increase the future cost of external borrowing, which had already been creeping up. Vietnam paid 333 basis points above US Treasuries for a US$1bn bond issued in January, compared with a 184-basis-point premium paid by the Philippines on a similar issue at around the same time. Moreover, the downgrade is likely to have an impact on the cost of servicing Vietnam's existing sovereign debt.

Power outages raise concerns over the electricity supply

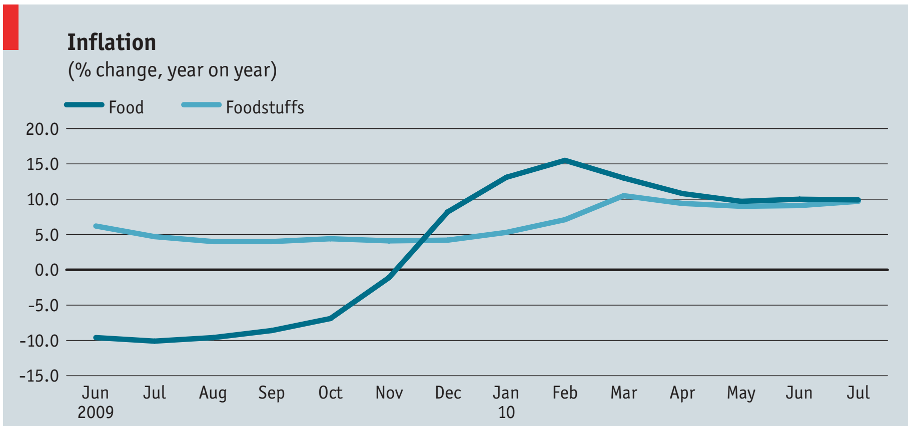
Foreign and local businesses in Vietnam continue to be alarmed by the sometimes erratic supply of electricity. Supply worries have been compounded by high summer temperatures in the region of the capital, Hanoi, which have led to soaring demand as power-hungry airconditioners are switched on, resulting in frequent power cuts. Vietnam's policymakers are now encouraging greater investment in the electricity sector. However, constructing new power plants can take years, and Vietnam's relatively rapid rate of economic growth mean that demand is rising faster than supply.

The government is also looking to develop alternative power sources, and in particular wind power. Local companies will be offered tax incentives, land allocations and special financing arrangements to encourage them to invest in wind power. According to the government, 21 wind projects with an average capacity of 30 mw each are in the process of being developed. Even some local families have erected their own mini-turbines to generate small amounts of power that they can use for domestic purposes. However, there is a stumbling block to a larger-scale roll-out of power-generating wind turbines in Vietnam. EVN will pay up to 10 US cents for every kilowatt-hour of electricity produced, but production costs are at least 16 US cents/kwh. This, at least in the short term, could provide a substantial disincentive for firms and households to pump money into wind power. In a separate development, EVN announced on July 4th that it had begun building a new US$1.2bn coal-fired power plant with a capacity of 600 mw. Japan's official development assistance programme is funding 85% of the plant's construction costs. The power station is expected to be operational by the end of 2013.

Economic performance

Inflationary pressures remain under control in July

There is some room for optimism regarding Vietnam's economic performance, owing to the fact that inflation has moderated. According to the General Statistics Office (GSO), consumer prices rose by 8.2% year on year in July, compared with 8.7% in June. July's inflation figure was below the double-digit threshold that appears to be the point at which policymakers will take action to contain inflationary pressures. The fact that inflation has remained in single digits since May will give the government room to continue to encourage domestic credit growth without triggering an immediate spike in the cost of living—a possibility to which many Vietnamese are acutely sensitive.



Sources: General Statistics Office of Vietnam; Haver Analytics.

Prices for some items in Vietnam continued to rise significantly in year-on-year terms in July. The cost of food and foodstuffs, which together account for over

40% of the goods and services used to calculate the consumer price index (CPI), rose by 9.3% and 9.8% respectively. Meanwhile, transport costs rose by 9.8%. Prices for food and fuel have a significant impact on the disposable incomes of ordinary Vietnamese, and particularly those who live outside the main urban centres and earn below-average incomes. Prices for housing and construction materials also picked up significantly in July, rising by 13.5% year on year, although in month-on-month terms the cost of these items fell by 0.5%. After rising for seven consecutive months in year-on-year terms, inflation in this component of the CPI basket fell for the second straight month in July.

The government revises up its GDP forecast for 2010

Government officials are confident that the current accommodative monetary policy stance is working well, and have begun to push up their forecasts of real GDP growth in 2010 as a result. The deputy minister of planning and investment, Cao Viet Sinh, has indicated that GDP could expand by 6.7% this year, higher than the current government target of 6.5%. The potential improvement in the economy's growth prospects also reflects relatively strong export data compared with 2009, owing to the ongoing recovery in domestic demand in some of Vietnam's main export markets. The Ministry of Planning and Investment is targeting average annual economic growth of 7.5-8.5% in the five years from 2011, slightly higher than the CPV's forecasts of growth in the period of 7-8%.

Exports dip in July, while the value of imports rises

The trade deficit continued to widen in July on the back of weaker export figures compared with June and continued buoyant growth in the value of imports. According to the GSO, the deficit on the trade account widened to an estimated US$7.4bn in July, compared with US$6.3bn in June. The value of exports fell by 8.2% to an estimated US$5.8bn in July, while imports held steady at around US$7bn. The dip in exports was partly a reflection of the lower volume and value of crude oil exported in July, but was also owing to a sharp contraction in the value of exports of valuable stones and metals. On the positive side, imports of materials for the important garment-manufacturing sector remained strong in July, suggesting that firms have orders for exports in the coming months. The relatively high value of imports of machinery, equipment and spare parts in recent months also suggests that investment in the manufacturing sector is rising, although not as rapidly as in the period preceding the global financial and economic crisis of 2008-09.

Retail sales record buoyant growth in January-July

The nominal value of retail sales grew strongly in the first seven months of 2010, increasing by 26.4% year on year to D877trn (US$46bn). All four subsectors, namely trade, hotels and restaurants, tourism, and services, recorded growth in excess of 20% year on year in January-July. The tourism sector recorded the highest rate of growth, with sales rising by 32.5% to D9.1trn in the first seven months of the year, although it accounted for just 1% of total retail sales. The biggest contributor to retail sales remains the so-called trade sector (consisting of sales by private and state-owned retail outlets other than those classified as being part of other subsectors), which amounts to around 80% of total retail sales.

Data and charts

Annual data and forecast

	2005[a]	2006[a]	2007[a]	2008[a]	2009[b]	2010[c]	2011[c]
GDP							
Nominal GDP (US$ bn)	52.9	61.0	71.1	90.3	93.2[a]	102.5	115.9
Nominal GDP (D trn)	839.2	974.3	1,143.7	1,485.0	1,658.4[a]	1,951.7	2,253.8
Real GDP growth (%)	8.4	8.2	8.5	6.2	5.4[a]	6.4	6.9
Expenditure on GDP (% real change)							
Private consumption	7.3	8.3	10.8	9.2	4.0	7.4	7.5
Government consumption	7.9	8.8	8.9	7.5	8.2	8.0	7.8
Gross fixed investment	9.8	9.9	24.2	3.8	2.0	6.2	7.2
Exports of goods & services	20.5	17.5[b]	15.6[b]	14.8[b]	-5.9	14.7	11.1
Imports of goods & services	15.9	18.7[b]	27.8[b]	15.1[b]	-5.6	14.1	10.2
Origin of GDP (% real change)							
Agriculture	4.0	3.4	3.7	4.4	1.8[a]	2.0	3.0
Industry	10.7	10.4	10.6	5.7	5.5[a]	8.0	6.8
Services	8.5	8.3	8.7	7.3	6.6[a]	6.7	8.6
Population and income							
Population (m)	83.5	84.4[b]	85.3[b]	86.2[b]	87.0	87.8	88.7
GDP per head (US$ at PPP)	2,132[b]	2,358[b]	2,604[b]	2,793[b]	2,953	3,155	3,383
Recorded unemployment (av; %)	5.3	4.8	4.6[b]	4.7[b]	6.5	6.2	6.0
Fiscal indicators (% of GDP)							
Central government balance	-4.1	-2.9	-7.3	-5.4[b]	-8.9	-7.6	-6.8
Net public debt	44.0	45.9[b]	49.9[b]	48.6[b]	51.8	51.6	50.6
Prices and financial indicators							
Exchange rate D:US$ (end-period)	15,916	16,055	16,010	17,433	18,472[a]	19,301	19,660
Exchange rate D:€ (end-period)	18,775	21,188	23,379	24,234	26,474[a]	23,064	23,395
Consumer prices (end-period; %)	8.7	6.6	12.6	21.6	6.5[a]	10.8	6.6
Stock of money M1 (% change)	22.2	20.7	48.9	-0.4	55.5	27.3	29.5
Stock of money M2 (% change)	30.9	29.7	49.1	20.7	33.4	32.3	24.7
Lending interest rate (av; %)	11.0	11.2	11.2	15.8	10.4	11.9	11.4
Current account (US$ m)							
Trade balance	-2,439	-2,776	-10,438	-12,782	-9,859	-12,429	-12,275
Goods: exports fob	32,447	39,826	48,561	62,685	57,061	69,900	76,939
Goods: imports fob	-34,887	-42,602	-58,999	-75,468	-66,920	-82,328	-89,214
Services balance	-296	-8	-755	-835	-790	-853	-588
Income balance	-1,205	-1,429	-2,190	-4,400	-3,379	-3,803	-4,684
Current transfers balance	3,380	4,049	6,430	7,311	6,331	7,167	8,105
Current-account balance	-560	-164	-6,953	-10,706	-7,697	-9,918	-9,443
External debt (US$ m)							
Debt stock	19,114	20,126	23,865	26,158	27,836	32,696	35,827
Debt service paid	954	949	1,249	1,344	1,114	1,211	1,444
Principal repayments	519	495	640	776	710	733	818
Interest	434	454	609	568	404	478	626
International reserves (US$ m)							
Total international reserves	9,217	13,591	23,748	24,176	16,803[a]	22,210	24,773

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts.

Source: IMF, *International Financial Statistics*.

Quarterly data

	2008		2009				2010	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
Prices								
Consumer prices (2005=100)	149.8	149.4	151.3	151.5	153.6	156.2	162.6	n/a
Consumer prices (% change, year on year)	27.7	23.6	15.5	6.2	2.6	4.6	7.5	n/a
Financial indicators								
Exchange rate D:US$ (av)	16,666	16,898	17,499	17,785	17,820	18,094	18,742	18,993
Exchange rate D:US$ (end-period)	16,575	17,433	17,756	17,801	17,841	18,472	19,080	19,065
Deposit rate (av; %)	17.0	11.0	6.9	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)	20.1	14.1	9.5	n/a	n/a	n/a	n/a	n/a
Refinancing rate (end-period; %)	15.0	10.3	8.0	n/a	n/a	n/a	n/a	n/a
Treasury bill rate (av; %)	15.5	11.2	6.8	n/a	n/a	n/a	n/a	n/a
M1 (end-period; D trn)	321.8	433.3	462.3	507.8	515.5	n/a	n/a	n/a
M1 (% change, year on year)	-8.8	-0.4	16.7	48.5	60.2	n/a	n/a	n/a
M2 (end-period; D trn)	1,347.5	1,513.5	1,645.3	1,776.0	1,842.3	n/a	n/a	n/a
M2 (% change, year on year)	21.3	20.7	26.5	37.1	36.7	n/a	n/a	n/a
Foreign trade (US$ m)								
Exports fob	17,839	14,163	14,059	13,431	13,873	15,179	14,456	17,644
Imports cif	-19,087	-15,757	-12,560	-17,027	-18,547	-20,787	-17,772	-20,877
Trade balance	-1,248	-1,594	1,499	-3,596	-4,674	-5,608	-3,316	-3,233
Foreign payments (US$ m)								
Merchandise trade balance	-2,41.0	-1,092.0	2,304.0	-2,553.0	-3,452.0	n/a	n/a	n/a
Services balance	-291	188	-114	-330	-266	n/a	n/a	n/a
Income balance	-617	-2,848	-986	-846	-824	n/a	n/a	n/a
Net transfer payments	1,585	1,853	1,558	1,569	1,599	n/a	n/a	n/a
Current-account balance	436	-1,899	2,762	-2,160	-2,943	n/a	n/a	n/a
Reserves excl gold (end-period)	23,848	23,890	23,008	20,260	18,769	16,447	n/a	n/a

Sources: IMF, *International Financial Statistics*.

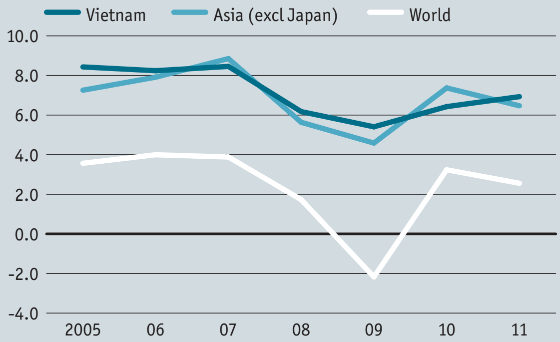
Monthly data

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate D:US$ (av)												
2008	15,992	15,951	15,898	16,094	16,171	16,490	16,798	16,605	16,596	16,679	16,936	17,079
2009	17,463	17,482	17,553	17,776	17,785	17,796	17,809	17,816	17,834	17,852	17,960	18,472
2010	18,472	18,679	19,077	19,011	18,987	18,981	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate D:US$ (end-period)												
2008	15,971	15,931	16,105	16,116	16,246	16,842	16,755	16,525	16,575	16,813	16,974	17,433
2009	17,475	17,475	17,756	17,784	17,784	17,801	17,815	17,823	17,841	17,862	18,485	18,472
2010	18,472	18,925	19,080	18,960	18,980	19,065	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M1 (% change, year on year)												
2008	56.8	35.3	24.8	17.7	10.9	2.3	-5.2	-7.3	-8.8	-12.3	-12.0	-0.4
2009	-3.8	5.2	16.7	27.1	34.7	48.5	54.9	58.4	60.2	59.2	n/a	n/a
2010	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M2 (% change, year on year)												
2008	48.2	41.4	37.0	30.5	29.1	25.8	23.1	21.0	21.3	18.4	17.9	20.7
2009	20.8	24.1	26.5	32.5	33.9	37.1	38.5	38.6	36.7	36.5	n/a	n/a
2010	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Deposit rate (av; %)												
2008	7.2	9.0	11.2	11.5	13.3	16.6	16.9	17.2	16.9	15.2	10.0	7.8
2009	7.0	6.5	7.1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2010	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2008	11.2	11.2	14.6	14.3	16.5	19.1	20.3	20.2	19.9	18.0	13.3	11.0
2009	10.1	9.4	9.2	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2010	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Consumer prices (av; % change, year on year)												
2008	14.1	15.7	19.4	21.4	25.3	26.8	27.0	28.3	27.9	26.7	24.2	20.0
2009	19.4	15.5	12.0	9.2	5.6	3.9	3.3	2.0	2.4	3.0	4.3	6.5
2010	5.9	7.8	8.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Goods exports fob (US$ m)												
2008	4,911	3,800	4,700	5,100	5,150	5,500	6,547	6,018	5,274	5,044	4,219	4,900
2009	3,719	5,028	5,312	4,279	4,415	4,737	4,806	4,523	4,544	5,026	4,686	5,467
2010	5,013	3,740	5,592	5,332	6,312	6,000	n/a	n/a	n/a	n/a	n/a	n/a
Goods imports cif (US$ m)												
2008	7,198	5,800	7,000	7,850	8,000	6,800	7,300	6,276	5,511	5,706	4,651	5,400
2009	3,329	4,188	5,043	5,456	5,669	5,902	6,323	5,848	6,376	6,625	6,767	7,395
2010	5,958	5,070	6,747	6,494	7,183	7,200	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (US$ m)												
2008	-2,287	-2,000	-2,300	-2,750	-2,850	-1,300	-753	-258	-237	-662	-432	-500
2009	390	840	269	-1,177	-1,254	-1,165	-1,517	-1,325	-1,832	-1,599	-2,081	-1,928
2010	-945	-1,330	-1,155	-1,162	-871	-1,200	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US$ m)												
2008	24,336	25,836	26,436	25,298	23,607	22,262	21,756	22,383	23,848	23,820	23,243	23,890
2009	22,830	22,653	23,008	20,931	20,790	20,260	19,072	18,802	18,769	18,320	17,400	16,447
2010	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, *International Financial Statistics*; Haver Analytics.

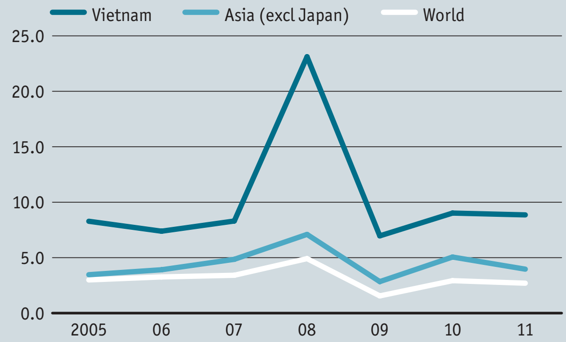
Annual trends charts

Real GDP growth
(% change)



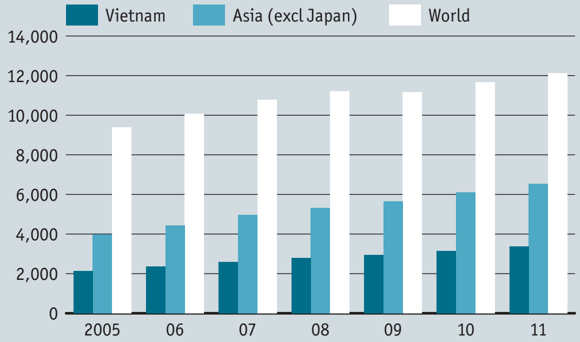
Source: Economist Intelligence Unit.

Consumer price inflation
(av; %)



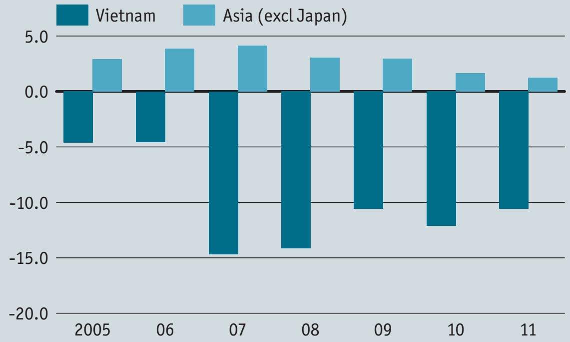
Source: Economist Intelligence Unit.

GDP per head
(US$; PPP)



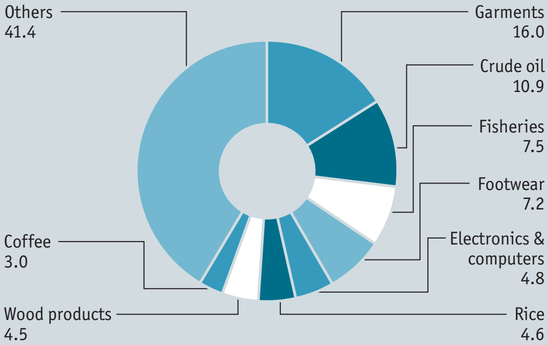
Source: Economist Intelligence Unit.

Trade balance
(% of GDP)



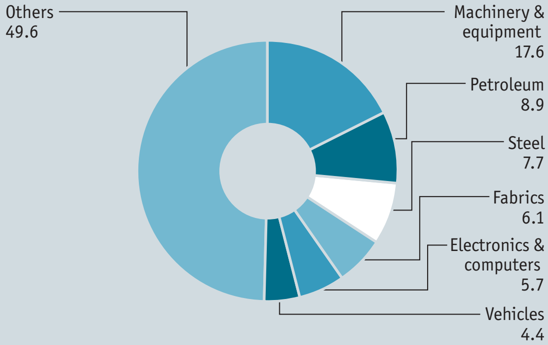
Source: Economist Intelligence Unit.

Main exports, 2009
(% of total)



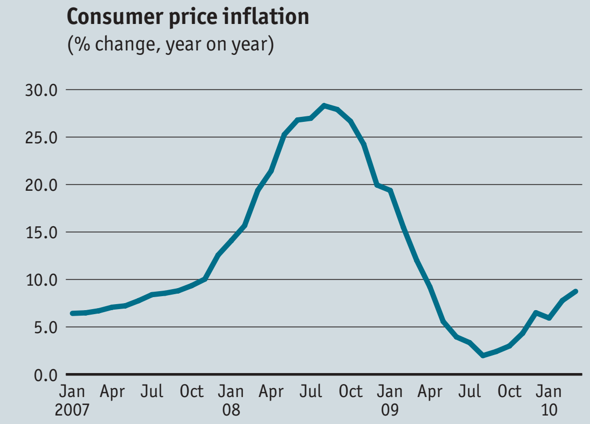
Source: Economist Intelligence Unit.

Main imports, 2009
(% of total)



Source: Economist Intelligence Unit.

Monthly trends charts



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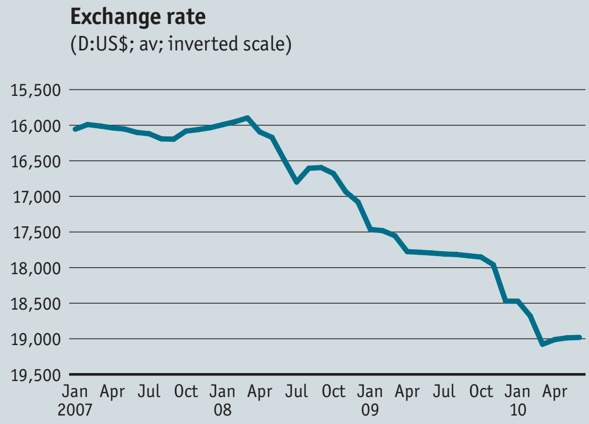
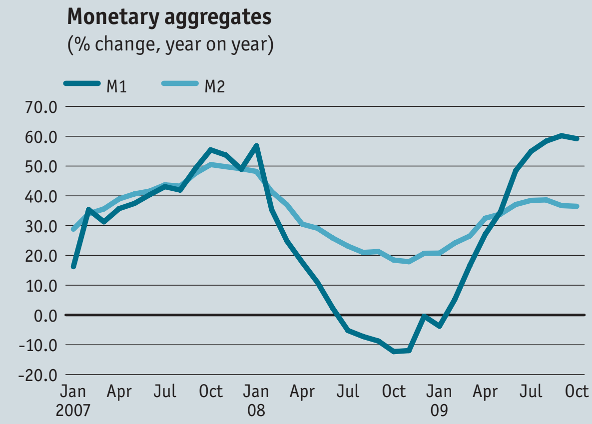
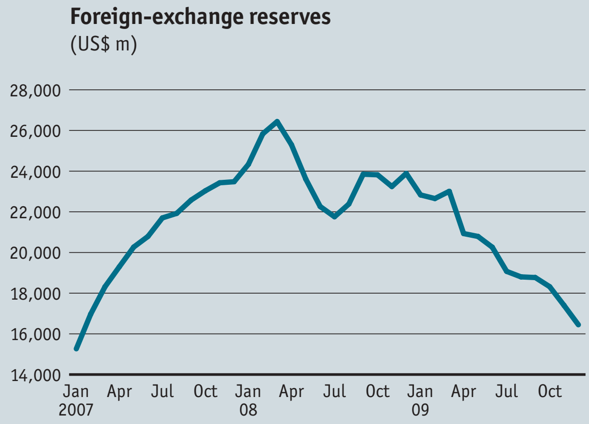


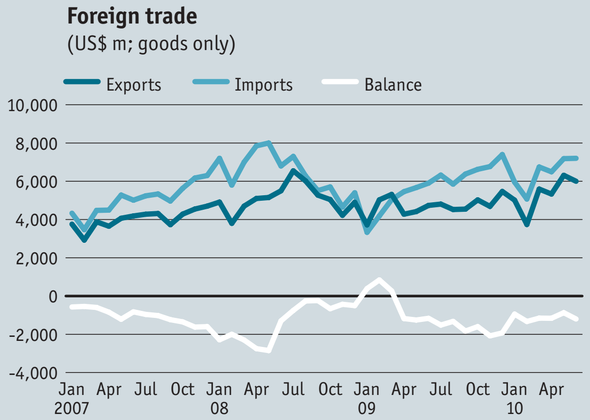
Source: Economist Intelligence Unit.



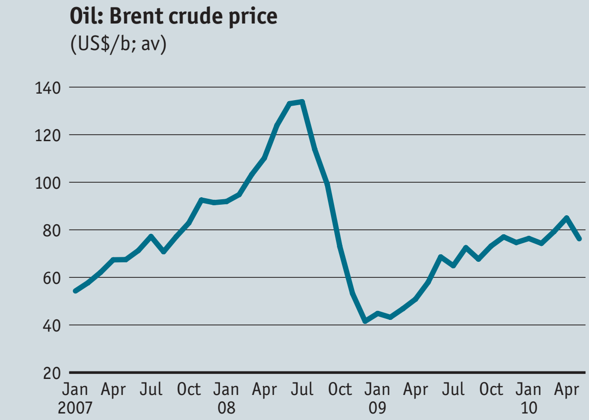
Source: Economist Intelligence Unit.



Source: Economist Intelligence Unit.

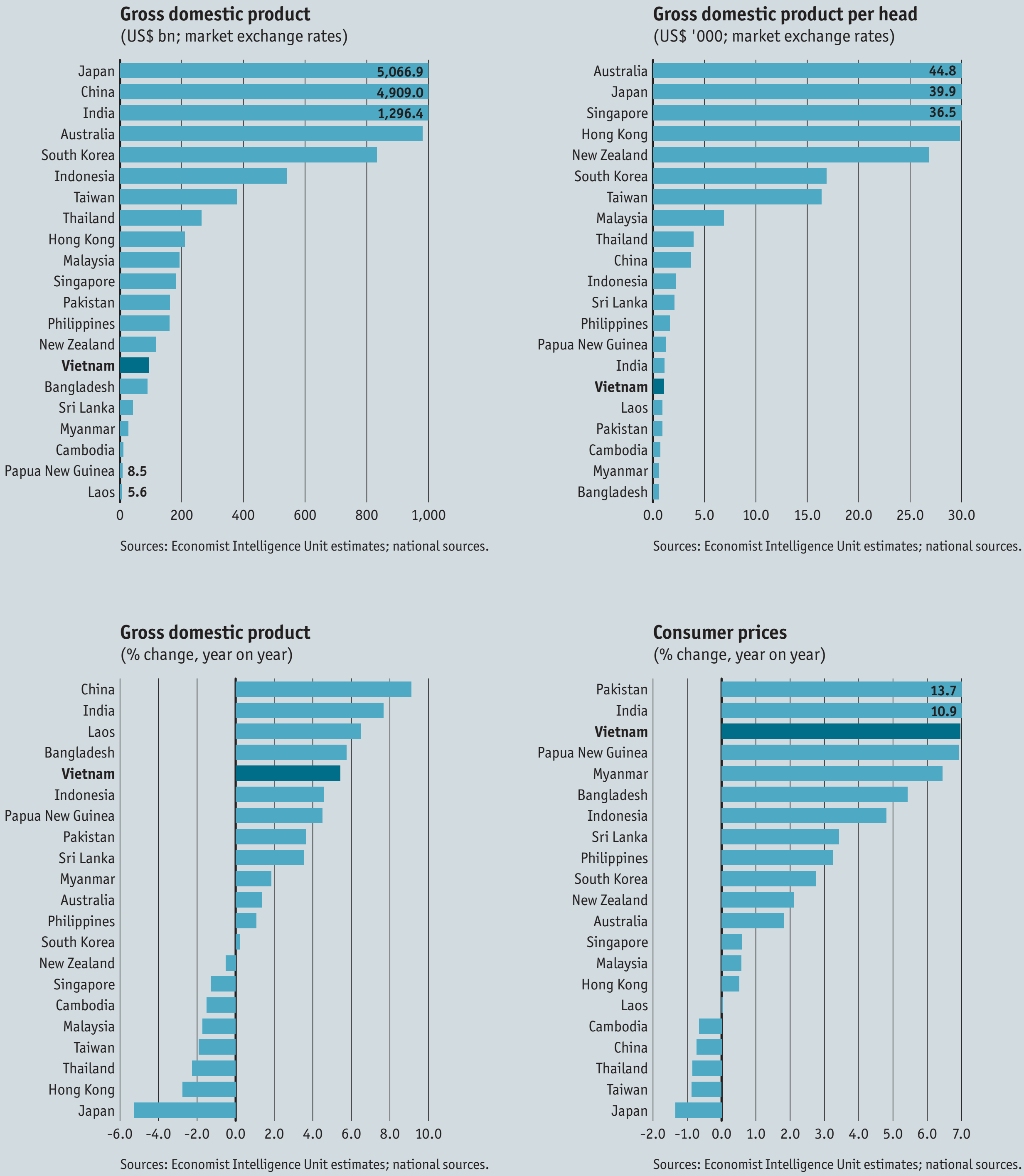


Source: Economist Intelligence Unit.



Source: Economist Intelligence Unit.

Comparative economic indicators, 2009



Country snapshot

Basic data

Land area	331,051 sq km
Population	86m (2009, General Statistics Office estimate)
Main towns	Population (of province) in '000 (2009) Ho Chi Minh City 7,165 Hanoi (capital) 6,472 Haiphong 1,842
Climate	Tropical monsoon; north cool and damp in winter (November-April), hot and rainy in summer; south more equable; centre most subject to typhoons. The rains are highly unpredictable
Weather in Hanoi (altitude 216 metres)	Hottest month, June, 26-33°C; coldest month, January, 13-20°C; wettest month, August, 343 mm average rainfall; driest month, January, 18 mm average rainfall
Weather in Ho Chi Minh City (altitude 9 metres)	Hottest month, April, 24-35°C; coldest month, January, 21-32°C; wettest month, September, 335 mm average rainfall; driest month, February, 3 mm average rainfall
Language	Vietnamese (spoken by about 90% of the population); English (increasingly favoured as a second language); some French; a little Russian and German; minority languages such as Hmong, Thai, Khmer in more remote rural areas
Weights and measures	Metric system. Local land measurement: 1 mau = 3,600 sq metres (north); 1 mau = 5,000 sq metres (centre)
Currency	Dong (D). Average exchange rate in 2009: D17,800:US$1
Time	7 hours ahead of GMT
Public holidays	January 1st (New Year's Day); February 14th-18th (Tet, Lunar New Year); April 30th (Liberation of Saigon); May 1st (Labour Day); September 2nd (National Day)

Political structure

Official name	Socialist Republic of Vietnam
Form of state	One-party rule
The executive	The cabinet is constitutionally responsible to the National Assembly, which is elected for a five-year term
Head of state	The president, currently Nguyen Minh Triet
National legislature	The unicameral 493-member Quoc Hoi (National Assembly) meets biannually; an election takes place every five years. The assembly appoints the president and the cabinet
Local government	Centrally controlled provinces and municipalities are subdivided into towns, districts and villages, which have a degree of local accountability through elected People's Councils
Legal system	The regional people's courts and military courts operate as courts of first and second instance, with the Supreme Court at the apex of the system
National elections	Elections for the National Assembly and People's Councils took place in May 2007; the next are due in 2012
National government	The Communist Party of Vietnam, and in particular its politburo, controls both the electoral process and the executive
Main political organisations	The Communist Party of Vietnam (general secretary: Nong Duc Manh); the Vietnam Fatherland Front

Main members of the cabinet	**Prime minister**	Nguyen Tan Dung
	Deputy prime ministers	Nguyen Sinh Hung
		Pham Gia Khiem
		Hoang Trung Hai
		Nguyen Thien Nhan
		Truong Vinh Trong
Key ministers	**Agriculture & rural development**	Cao Duc Phat
	Construction	Nguyen Hong Quan
	Culture, sports & tourism	Hoang Tuan Anh
	Education & training	Nguyen Thien Nhan
	Finance	Vu Van Ninh
	Foreign affairs	Pham Gia Khiem
	Industry & trade	Vu Huy Hoang
	Information & communications	Le Doan Hop
	Interior	Tran Van Tuan
	Justice	Ha Hung Cuong
	Labour, war invalids & social affairs	Nguyen Thi Kim Ngan
	National defence	Phung Quang Thanh
	Natural resources & environment	Pham Khoi Nguyen
	Planning & investment	Vo Hong Phuc
	Public health	Nguyen Quoc Trieu
	Transport	Ho Nghia Dung
Central bank governor	Nguyen Van Giau	