

## A workshop to announce the 2011 Vietnam annual economic report

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**Abstract.** On May 17th, the University of Economics and Business - Vietnam National University, Hanoi (VNU) collaborated with the United Kingdom Department for International Development (DFID) and the Vietnam Center for Economic Research and Policy (VERP) to organize a workshop to announce the 2011 Vietnam Annual Economic Report titled “The Economy at a Crossroad.” The report is a major product of the strategic research program on “Macroeconomic Theory and Policy: the Condition of Economic Integration in Vietnam” hosted by the University of Economics and Business - VNU and conducted by the VERP. This annual report reviewed major economic issues in the past year, discussed economic perspectives for the coming year, and suggested policy recommendations.

Present at the workshop included leaders and representatives of governmental, policy planning, theoretical and research organizations both domestic and international. Other attendees included leaders from universities and research institutes and participants from Vietnam-based embassies, developmental organizations, associations, enterprises, banks and news agencies in the field of economics and finance in Vietnam.

The 2011 Vietnam Annual Economic Report was produced in the context of the dramatically changing global economy after two years of regression from 2008 to 2009, and with the Vietnamese economy facing new and difficult challenges resulting from a decade of growth. These challenges included a high rate of inflation, budget deficits, and trade deficits.

These challenges have not improved, and enterprise reform has made little progress. The report consists of nine chapters and two appendices.

### 1. The Vietnamese economy at a crossroad

Vietnamese managers and policy makers may be annoyed by the following statement “the Vietnamese economy is now at a crossroad”. This statement is not intended to criticize the transition that Vietnam is considering - to shift from a centrally planned economy into a socialist-oriented market economy - but the statement is directed at the poor management and abuse of administrative orders for an open economy that have existed in Vietnam. Dr. Nguyen Duc Thanh, the editor of the 2011 Vietnam Annual Economic Report, says: “The economy is now at a turning point and it must make a choice between various

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objectives. For instance, the existing economic model that was developed in the last decade, relied a lot on state-owned enterprises and considered state economic groups as the main players. This model has become very controversial as it has caused an uneven distribution of labor and explicit risks.”

In fact, the existing economic model relies on increasing input. The data analyzed by the report showed that despite its growth, the Vietnamese economy hasn't been able to satisfy practical demands. In reality, the economic development model that Vietnam has applied no longer works because, if additional resources are further pumped into the economy, inflation will increase, and macro instability and the speed of economic growth will lessen. Therefore, most of the existing policies and development models need to be changed. The quality of economic education and management of enterprises and ownership reform must be improved. There is a need to find which economic sector can lead and motivate the whole national economy. Although state-owned enterprises and state economic corporations account for a large percentage of Vietnamese enterprises, they have made little contribution to the country's economic growth. This is an extremely controversial reality. Sadly, they have generated many risks for the economy. These state-owned enterprises and corporations have exerted pressure on the commercial banking system through debts and the heavy use of natural resources.

## 2. Disadvantages suffered

One of the important messages that the Report has sent to policymakers is as follows: Vietnam is in a more disadvantaged position in 2011 in comparison with the year 2008 when Vietnam was heavily impacted by the global financial crisis and suffered huge difficulties stemming from inside the country. In 2008 the budget deficit was not so great and the fiscal policy could have had the flexibility to change the level of revenue. Inflation increased but the

domestic interest rate was not high and the possibility for an increased interest rate to restrain inflation was acceptable. In addition, the foreign exchange reserve in 2008 was at a peak and this impacted the foreign exchange market strongly. Noticeably local people and businesses seemed optimistic, as the crisis had just started. However, in 2009, the excessive use of fiscal tools increased public debts sharply and the budget deficit remained at a high level. And very little room was left, in terms of the fiscal aspects, for policy application. In 2010, we continued to intervene aggressively in monetary policy by increasing interest rates, tightening money supply and credit, together with a strong reduction of foreign exchange reserves to stabilize rates. As a result there was not much room left for policy adjustment on the monetary aspect. Therefore, in 2011, we had to bear the consequences of the measures that had been used to overcome economic difficulties over the previous two years. The Report concluded: “In 2011, the policy tool was no longer used on a large (maybe “broad scale” or “wide scale” would be better) scale. This was clearly seen in the early months of the year when we had to use a variety of administrative tools drastically to intervene in the markets”.

## 3. Two growth scenarios

In the first scenario, monetary policy was tightened “patiently” (which lasted till the end of the year). Associated with this public investment spending was reduced “strictly” following Resolution 11/NQ-CP. Inflation has increased to approximately 15.5%, and the GDP has also grown by 6.2% which is only a little lower than that in 2010 and the quota predicted for this year. According to the Report, the increased inflation stemmed from the adjusted prices of essential items and raw materials, as well as from the increased price momentum that followed after some loosening measures had been applied in the previous year. In the event that the world price of raw

materials plummets, inflation will be reduced further by the end of the year. This will help to slow the momentum of price increases for the whole year.”

As highlighted in the second scenario, if the Vietnamese Government does not curb inflation and stabilize the economy at the macro level drastically, inflation may rise even higher than 18%. At the same time the expanded monetary policy may enhance GDP growth to a little over 6.5%. Compared to the previous year, there is little of growth since it is directly impacted by the economic instability in 2011. The high level of inflation described in this scenario implies large macro risks, and this means inflation is very possibly out control.

#### **4. Short term risk: Inflation**

The Report asserts that the Vietnamese economy is facing short, medium and long-term risks. “In the short term, inflation and macro-instability may pose big problems for the year 2011.” As predicted by of the research team, even if macro economic restraints and stabilization measures are applied drastically in the remaining seven months of the year, inflation may reach a level of 15.5% for the year.

An analysis of the inflation and interest rate policy shows that the macro economic stabilization policy is passive. For example, most of the tightening monetary policy measures targeted after inflation began while the introduction of interest rate policy was meant to accomodate inflation rather than to curb inflation. These policies were applied once inflation had occurred but had a minimal etc. People tend to hold a memory of previous inflation and have nervous expectations of future inflation. Dr. Nguyen Duc Thanh said: “Poor active policy is as harmful as policy mistakes and can accumulate risks for the economy”. So, to combat inflation effectively, according to the research team, the Government must put in more effort in ant-inflation commitments. As a first step it must be able to maintain a low level of inflation

for at least six months in order to regain the confidence of the market.

The report noted the growth of inflation is significant in the short term with increased prices. It is not accumulated budget deficit that influences inflation but funding deficit. Increased interest rates and increased money supply can cancel each other out. Money supply and interest rates both impact inflation, but their cancelling of each other causes numerous difficulties for monetary policy enforcement, and accordingly it hinders inflation control.

According to Dr. Vo Tri Thanh, Deputy Director of the Central Research Institute of Economic Management, inflation in Vietnam is impacted by supply and demand. However, to limit the impact of increased costs on inflation, Vietnam has not had any effective tools. Vietnam has no strategic storage in which to reserve resources and essential fuel for production. There is no ability to subsidize coal, electricity or gasoline. It can only increase prices of these commodities. Therefore, inflation decreases due to falling investment and reduced spending.

#### **5. Medium term risk: Caution for the commercial bank system**

As emphasized in the report, the commercial banking system holds medium term risks. There are two main contributors to the increased pressure on the commercial banking system. These are state-owned businesses and the asset market. State owned businesses have underlying fiscal risks and the asset market has accumulated potential risks due to long lasting high property prices (the property bubble). Dr. Le Xuan Nghia - Vice Chairman of the National Financial Monitoring Committee says the higher the interest rates, the more capital flows into the public sector regardless of interest rates. According to Dr. Vo Tri Thanh, Vietnamese commercial banks are now facing four challenges: shortage of liquidity, a false currency structure, bad debt, and total outstanding debt in the real estate market.

The research team pointed out that the development model based on expanded investment has widened the gap between savings and investment and has increased the current balance deficit. Due to these imbalances, the economy becomes more vulnerable to external shocks. A direct risk of this is a monetary crisis. According to the report: Vietnam will go gradually into an economic spiral with inherent banking and currency crisis (a dual crisis).

## 6. Recommendations

According to Dr. Nguyen Duc Thanh, Vietnam has very little room for policy adjustment for macro-economy restraint and stabilization. Following Resolution No. 11, more developed policies should be enforced. These included cutting public investment, controlling credit growth and increasing money supply. However, how they are enforced in the remaining months of the year is very important.

The research team believes that a top priority for economy stabilization is to resolutely and patiently tighten monetary policy. Fiscal policy should also be tightened as it takes into account the possibility for long-term growth. Fiscal discipline is vital for restoration of the strength of the economy and is a major challenge for policy makers. Daily operation or technical operation needs a much longer vision, avoiding precipitous action and avoiding the generation of uncertain expectations for the economy. Construction investment needs to be cut simultaneously with the diversification or socialization of construction investment such as PPP, BOT, BT, etc. However, it is impossible to cut investment

spending widely, because it will affect the possibility of long-term growth.

For now, deposit interest rates should be increased and ceiling interest rates should be removed. Moreover, the required level of banking reserve must be increased to control money supply as specified by Resolution 11.

Economic experts forecast that Vietnamese public debt may pause temporarily in 2011, but in the following years, it will increase steadily. By 2015 it will reach 64% of the country's GDP and by 2020 will reach 70%. This scenario requires the Vietnamese Government to decrease the budget deficit from 7.7% of the GDP in 2009, to 4.3% in 2011, to 3.1% in 2015, and to 2.8% in 2020. Although it is asserted that the solvency and liquidity of our country's public debt is safe, there is an implication that there are many signs that indicate that cautious attention is needed.

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# Hội thảo công bố báo cáo thường niên kinh tế Việt Nam năm 2011

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