



VIETNAM—INFORMAL MID-YEAR CONSULTATIVE GROUP MEETING  
Ha Tinh City, June 8–9, 2011

IMF Staff Statement

1. When we met in Hanoi last December, there was a clear consensus that Vietnam needed to make a decisive break with the macroeconomic instability of the past three years. In February, the government responded, laying out its strategy for achieving this objective in Resolution 11. This meeting is a timely opportunity to take stock of progress under this strategy and assess the challenges ahead.<sup>1</sup>

*Assessment: Initial progress is encouraging, but significant challenges remain.*

2. **The government has made welcome progress in stabilizing the foreign exchange market.** The combination of a significant tightening of monetary policy in response to an increase in commodity prices, and a large-step devaluation of the dong, have provided greater support for the dong, albeit with assistance from administrative measures to curb trading in gold and foreign exchange outside of the banking system. The dong is now trading comfortably within the official exchange rate band, and enough appreciation pressure is being generated to allow the State Bank of Vietnam (SBV) to start replenishing its foreign exchange reserves, which rose by \$0.9 billion to \$13.5 billion in May. The stability in the foreign exchange market has helped ease offshore risk premia, with Vietnam's sovereign spreads and credit default swaps narrowing by around 100 bps from a peak of over 400 bps in February.

3. **That said, significant challenges remain.** Inflation is still on an upward trend, having reached close to 20 percent (year-on-year) in May and core inflation also on the rise, and is likely to rise further before it starts to ease toward the end of the year. More fundamentally, confidence in the government strategy's success remains fragile. Inflation expectations are still high, and expectations that the dong will again come under pressure remain entrenched, amid uncertainty about the government's willingness to sustain the recent tightening of monetary policy, its commitment to fiscal consolidation, and ongoing concerns about the health of the banking and corporate sectors. As a result, investors are still demanding high risk premia for investing in Vietnamese assets.

*Short-term priority: Strengthen the credibility of macroeconomic strategy.*

4. **The main short-term priority is to bolster confidence in the government's strategy to restore macroeconomic stability.** Much of the burden will inevitably fall on monetary

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<sup>1</sup> The 2011 Article IV consultation concluded on April 29 and there is strong consensus at the IMF on the messages outlined below.

policy. The immediate challenge will be to respond to the upward trend in inflation, and prevent it from feeding into higher inflation expectations and putting pressure on the dong. This requires further increases in policy rates, for which administrative measures cannot be a substitute. Furthermore, the SBV also has to persuade markets that the recent tightening of monetary policy will be sustained until inflation expectations are firmly back in single digits and reserves are rebuilt to more comfortable levels. Only then will conditions be established for a durable reduction in interest rates. For this, the SBV will require unambiguous political support. A strong signal that the government will remain committed to the Resolution 11 strategy beyond 2011 will be essential in this regard. A political commitment to clear medium-term objectives for inflation and external reserves, underpinned by appropriate credit growth targets, would be an important initial step toward strengthening the credibility of the SBV's monetary policy framework.

5. **Fiscal policy needs to more clearly support the monetary policy effort.** Although Resolution 11 included some measures to reduce the fiscal deficit, more could be done. We estimate that if the bulk of the projected revenue overperformance is saved, the fiscal deficit could be reduced to around 4 percent of GDP (international definition) in 2011, less than half its level in 2009. It would also be helpful if the government would set more ambitious medium-term targets for the fiscal deficit, reducing it to around 3 percent of GDP by 2015. This is achievable if efforts to strengthen non-oil revenues are sustained, and efforts to reprioritize and streamline public investment projects are carried through. A clear fiscal deficit reduction plan in the short and medium term would provide much needed support to monetary policy, and bolster more generally the credibility of the Resolution 11 strategy, by reassuring markets that the government is committed to financing Vietnam's substantial economic and social investment needs within a fiscal framework that keeps public debt on a sustainable path.

6. **It will be important to address concerns about vulnerabilities in the financial system.** Markets suspect that stress on the banking and corporate sectors will rise as the government seeks to stabilize the economy, and that credit quality could become a more prominent issue going forward, especially given the substantial surge in credit in the past three years. To assuage these concerns, the authorities will need to demonstrate they are taking proactive steps to limit the degree of vulnerability in the banking and corporate sector, through tightening prudential standards and supervision in the banking system, and improving governance and financial discipline in both state and private corporations. Facilitating the process of deleveraging in the corporate sector through raising new equity, and advancing reforms that would reduce, over time, corporate reliance on bank financing are also important. We welcome the authorities' request for an IMF/World Bank Financial Sector Assessment Program, and look forward to working with the authorities to strengthen the financial system, including through enhancing capacity and coordination among the supervisory authorities, and accelerate its development in a sound and sustainable manner.

*Structural reforms: Accelerate efforts to address bottlenecks in the economy.*

7. **We support development partners' emphasis on the need to accelerate structural reforms to improve Vietnam's long-term competitiveness.** Unless supply side constraints are alleviated and the inefficient economic system addressed, it will be difficult for Vietnam

to sustain rapid development, even with its current demographic dividend. Let me touch briefly on three priorities:

- ***Upgrading Vietnam’s infrastructure.*** Substantial investments in economic and social infrastructure are needed over the next decade to sustain Vietnam’s development. As we noted last year, the challenge is to finance these investments in a fiscally sustainable manner. This will, above all, require greater discipline in public financial management to improve the prioritization of public investment projects and their execution. Reinvigorating the equitization program and public-private partnerships would also be important.
- ***Strengthening economic institutions.*** As the current challenges underscore, confidence in the government’s economic management is a critical element of the overall investment climate. Such confidence is not only a function of government’s willingness to address economic challenges; it also depends on the effectiveness of the government’s policy instruments. These instruments need to adapt as Vietnam transitions toward an emerging market economy, away from directives and administrative controls toward price-based instruments operated within a clear, rules-based regulatory framework. At the macroeconomic level, reforms to make monetary policy more efficient and predictable; make fiscal policy more transparent, rules-based, and effective; and upgrade the supervision of the financial system are all key elements of the modernization strategy. Similar institutional reforms will be needed at the microeconomic level—in the legal system, dispute settlement mechanism, and broader administration—to provide an efficient and predictable business climate. Tackling financial and management weaknesses in state-owned enterprises and reducing their role in the economy would also be important.
- ***Modernizing information management.*** Managing a market economy smoothly hinges on high quality information and effective communication. This in turn requires investment in basic statistics systems and a willingness to make data available in an open and timely manner. Progress is being made on the former, but the latter is still too often impeded by a perception that information sharing is a zero-sum game: the more information that is shared, the greater the drain on officials’ power and influence. This affects not only public access to information, but information sharing within government as well. Overcoming these obstacles will be important for the quality of decision making and the effective communication of policies to the public. It would also help address the risk and uncertainty of investing and doing business in Vietnam, which is inimical to maintaining macroeconomic stability and the broader goal of developing Vietnam’s economy.

8. **Finally, we have long been bullish about Vietnam’s long-term potential.** The policy decisions made during this new five-year cycle will be critical to realizing that potential and ensuring that Vietnam continues on its remarkable path of economic development.

9. With these remarks, let me thank the authorities once again for the opportunity to participate in these discussions, and on behalf of the IMF let me reiterate our continued support to Vietnam on the road ahead.