CONSULTATIVE GROUP MEETING FOR VIETNAM
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1. Excellencies, ambassadors, distinguished participants, ladies, and gentlemen. It is my great pleasure to represent the International Monetary Fund at this annual Consultative Group Meeting. After nearly two years of macroeconomic stabilization efforts under Resolution 11, Vietnam is at a critical juncture. Even as the stabilization gains remain to be firmly entrenched, there is an urgent need to remedy major structural weaknesses that have become critical to the macroeconomy. Over the past few years and before the recent slowdown, the economy grew at levels that could not be sustained in the long run and accumulated vulnerabilities along the way. These vulnerabilities and structural constraints have diminished Vietnam's medium-term growth outlook. In 2013 and beyond, difficult challenges need to be tackled.

I. STOCKTAKING

2. **Is Vietnam better off in late 2012 than it was in 2011?** In many respects the answer is yes. Headline inflation has declined from more than 20 percent (y/y) in August 2011 to single digits in 2012, and the State Bank of Vietnam (SBV) seems to be on track to deliver single digit inflation for the year as a whole. The current account has been in surplus with strong export growth. The exchange rate has been stable this year and the level of international reserves has increased. As inflation has come down, it has been possible to bring down the structure of interest rates—policy rates, deposit rates, and lending rates. Some progress has also been made in stabilizing the banking sector. With these achievements, the authorities' macroeconomic management credentials and credibility in the market have improved. But there have been significant challenges as well. Growth has been slower in 2012 and it has been difficult for enterprises, especially small-and-medium enterprises (SMEs), to survive. Despite lower headline inflation, persistently high core inflation with weak demand conditions may still indicate high inflation expectations. Although liquidity in the banking system is ample, credit growth has been very weak and the level of inventories remains high. Based on SBV calculations, the level of nonperforming loans (NPLs) in the banking system is substantially higher than is reported by the banks. The real estate market has been frozen. There was some instability in financial markets related to high profile events in the banking sector in recent months. Progress in banking sector reform is slower than is

required. And related to this, progress in the reform of state-owned enterprise (SOEs) has also been significantly slower than is needed for building foundations for higher growth in the future.

3. **All this is occurring while there is still significant uncertainty about the global outlook.** The euro area crisis and the looming fiscal cliff in the United States are evidence that uncertainties remain elevated. Several emerging economies in the region have some room to cushion adverse developments, but Vietnam has limited policy space.

II. POLICY CHALLENGES

4. **Macroeconomic stability must be maintained.**

- ***Monetary and exchange rate policy.*** Maintaining low inflation and a stable exchange rate are very important elements of this effort. In the absence of a shock, it would be prudent for the SBV to maintain the policy rate at its current level for some time to come. At the same time, it must continue to monitor inflationary pressures closely, including those arising from global food and fuel prices. The level of international reserves has risen, but is still below what would be considered either comfortable or even adequate for dealing with large external shocks. So there is a need to further increase the level of international reserves through appropriately tight macroeconomic policies. Continued tight macroeconomic policies are also paramount to anchor inflation expectations and improve confidence in the dong. For this, it is important that fiscal policy continues to support the stabilization effort. In the case of an adverse shock, fiscal policy could be loosened somewhat, while monetary policy should continue to focus on reducing inflation. At the same time, given the relatively low level of reserves, the exchange rate should also be allowed to play its role in the adjustment process.

- ***Fiscal policy***. Overall stabilization efforts need to be supported by fiscal policy. In 2012, the weak economy and tax stimulus measures have depressed domestic revenue. Oil revenue continues to be strong because of favorable oil prices, but trade-related revenue has fallen as a result of weak imports, and domestic revenue has fallen because of economic weakness and tax stimulus measures. Budgetary expenditures have been broadly in line with plan, but the authorities plan to accelerate VND 15 trillion of off-budget spending from future years into 2012 to stimulate growth. It is likely that only about one-third of that amount will actually be disbursed in 2012 (with the remainder in early 2013), and not all VAT and CIT revenue deferred into 2013 will be collected because of widespread bankruptcies; therefore, the deficit could widen to a little under 5½ percent in 2012 before retrenching to about 4 percent in 2013 (*GFSM 2001* definition). Although the 2013 fiscal deficit is somewhat higher than envisaged at the time of the 2012 Article IV, it implies a withdrawal of fiscal stimulus and seems broadly appropriate, but there is no provision for the cost of bank recapitalization and SOE restructuring and reforms, including consequences of possible labor redundancies. In past international experience, SOE reforms have typically been associated with significant contingent liabilities.

5. **Structural reforms must be accelerated significantly.**

- ***Banking sector.*** Weaknesses and opacity in the banking sector undermine stability and will continue to constrain growth. Following an extended credit boom and connected lending to SOEs, the banking system is characterized by poor asset quality, underprovisioning, and inadequate capital adequacy. There is significant confusion among market participants about the level of NPLs. While banks report their NPLs to be around 4½ percent, the SBV's off-site estimate stands at a much higher 8¾ percent. NPLs are concentrated in SOEs, particularly those with real estate exposure. Given the weaker growth outlook and the need for banking sector reform and consolidation through 2015, NPLs are likely to increase further.

Despite reform proposals, the mergers of weak banks in late 2011 and early 2012, the recent discussions on an asset management company to address the NPL problem, and efforts to strengthen risk management and governance at banks, there is still a need for a clearly articulated and comprehensive bank resolution strategy. In addition, progress in implementing existing plans has been slow. A realistic resolution plan based on thorough on-site bank examinations, which should reveal the true extent of the damage and recapitalization requirements, is urgently needed. The resolution plan should differentiate between illiquid and insolvent banks, force existing shareholders to take losses before receiving new capital injections, and dispose of bad assets. Further delays in banking reform will raise the likelihood of increased contingent liabilities and pose risks for public debt sustainability.

The IMF stands with the Government of Vietnam in its efforts to strengthen the financial sector, including through technical assistance. Vietnam is participating in the Financial Sector Assessment Program (FSAP), jointly conducted by the IMF and the World Bank. Participation in this program is voluntary, and we are very encouraged by the decision of the Government of Vietnam to use this exercise to conduct a diagnostic of the entire financial sector and identify strengths and vulnerabilities. FSAPs have been performed in many countries, including the United States and China. Once this assessment is completed, concrete reforms that can create a sound and healthy financial sector can be implemented. Because the banking sector is by far the largest part of the financial sector in Vietnam, attention will be focused on this sector. Attention, however, will also be devoted to other sectors such as insurance and capital markets.

- ***The real estate sector.*** The real estate bust has contributed to weaknesses in the banking sector. The modern property sector is relatively new and limited to housing that is not affordable to the middle class. Developers armed with funding from banks, coupled with speculative demand in the belief that prices would keep rising, have led to overbuilding.

Despite real estate prices having already fallen by an estimated 30–50 percent from peak in some urban areas, the property market is in a supply glut that will take years to eliminate.

- ***State-owned enterprises.*** A considerable part of banking sector loans are to SOEs. Banking system problems cannot be addressed without dealing with the problems of the banks' borrowers. Therefore, SOE reform is paramount. As a first step, SOEs' true financial condition must be disclosed to the public, including their audited income statements and balance sheets. These enterprises use public money for their operations and the public needs to be informed of how that money is used. Once the true financial condition of these enterprises has been revealed, steps can be taken to improve their operations and governance structures. These plans must be formulated and implemented in a time-bound manner.

III. COMMUNICATION

6. **Sound policy management stands up to pressures and explains to the public that short-term sacrifices will create the conditions for larger benefits over the longer haul.** We have great confidence in the Vietnamese economy. Its development to date has been nothing but remarkable, and its potential to deliver rising living standards for the Vietnamese people in the future is high. But to realize this potential, the decisions made now and in the coming years will be critical.

- The government must not weaken its resolve to maintain macroeconomic stability. Calls for a loosening of macroeconomic policies often arise in countries in the circumstances that Vietnam is now undergoing. But policymakers committed to stability, growth, and reform resist these calls. At the same time, they take credible, visible, and measurable actions to ensure that conditions for sustained, durable growth are created.

- Following the approach outlined above will involve cost and sacrifice in the short run. The costs will be lower growth, a longer period of difficulties in the banking and SOE sectors, and a fiscal cost to pay for the reform and restructuring of these sectors. But if these costs are borne in the short run, the Vietnamese economy can emerge stronger in the longer term. In this regard, public investment, banking sector reform, and SOE reform have correctly been identified as the three critical areas in which actions would create conditions for higher long-term growth. The choice to undertake these efforts is admittedly not easy, but Vietnam's policymakers must now move quickly and decisively to implement the reform agenda and meet the public's expectations.

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With these remarks, I would like to thank the Government of Vietnam once again for the opportunity to participate in this meeting and for fruitful discussions. On behalf of the IMF, I would also like to reiterate our continued support for Vietnam on the road ahead. Thank you.