

Ministry of Finance/Ministry of Planning and Investment | Hanoi, 30 May 2016

The Vietnamese Economy

Assessment and Outlook

Prof. Dr. Stefan Kooths, Philipp Hauber
Forecasting Center



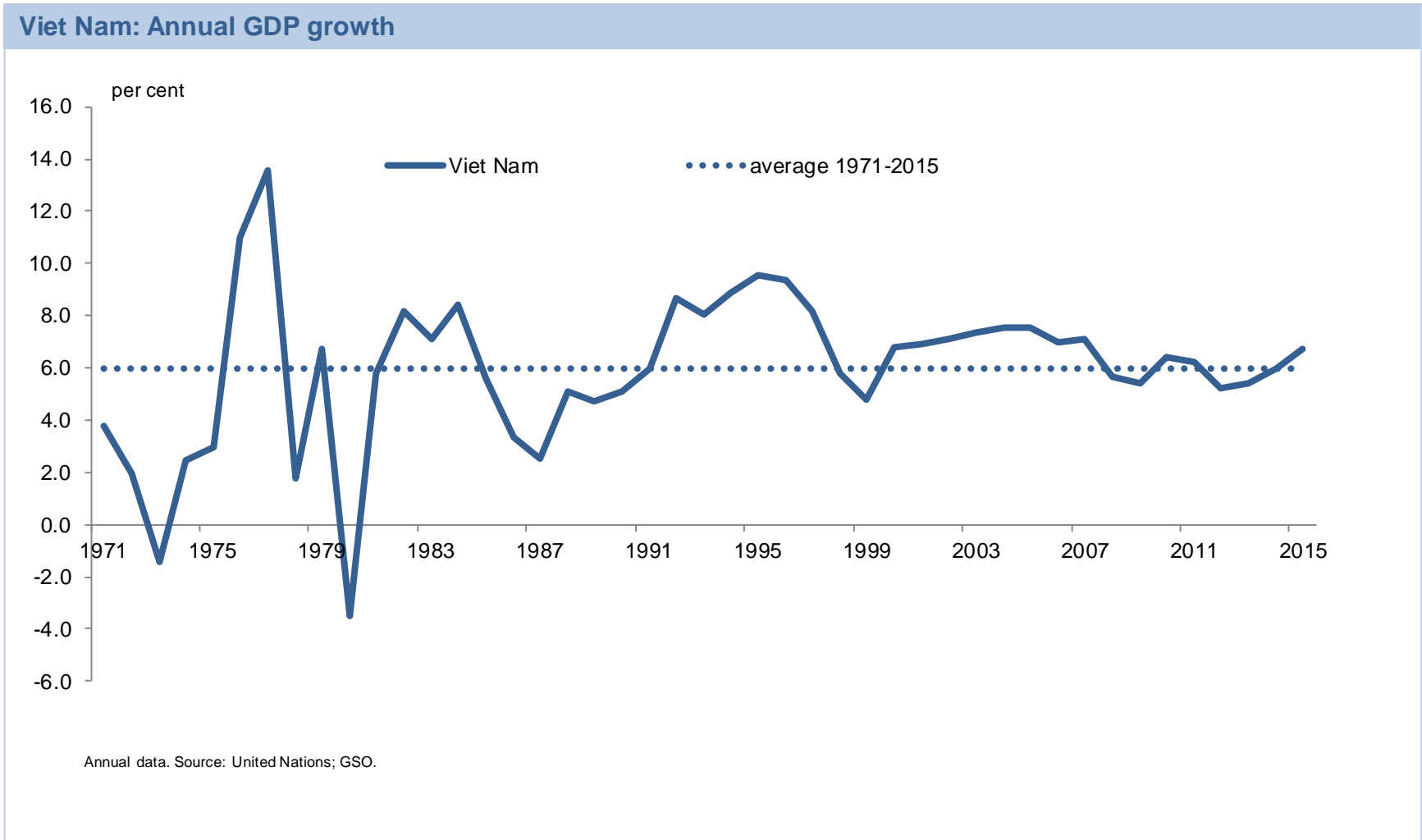
- Macroeconomic environment
 - » output
 - » prices
 - » money & credit
 - » external sector
 - » public finances

- Current developments and outlook

- Risks and opportunities

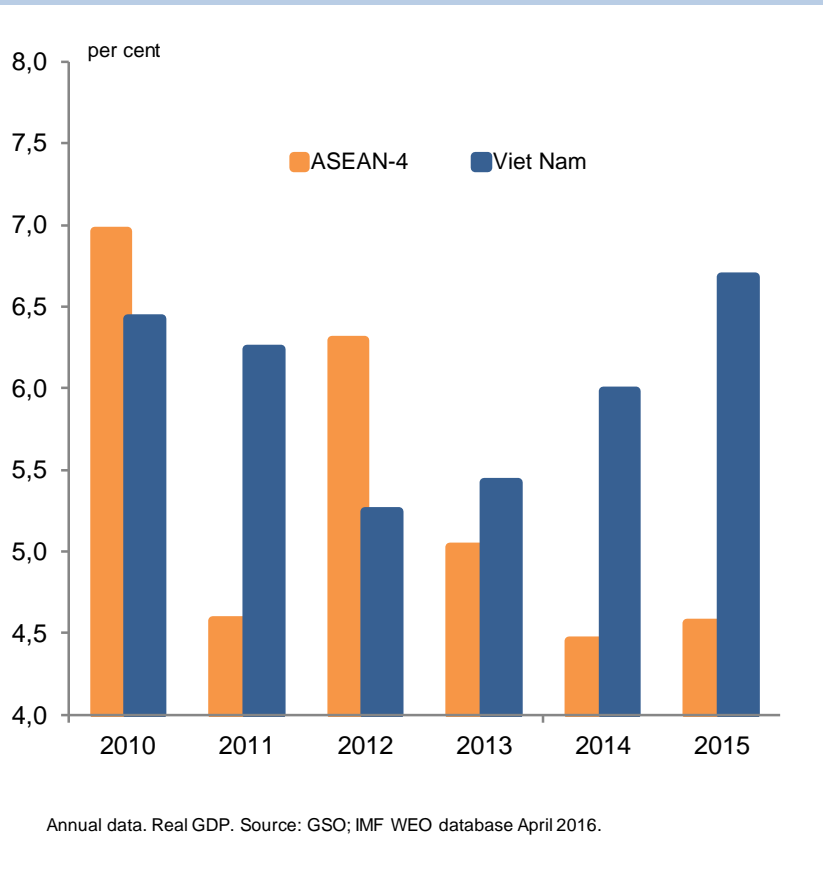
- Kiel Institute: key competencies

Macroeconomic environment - GDP



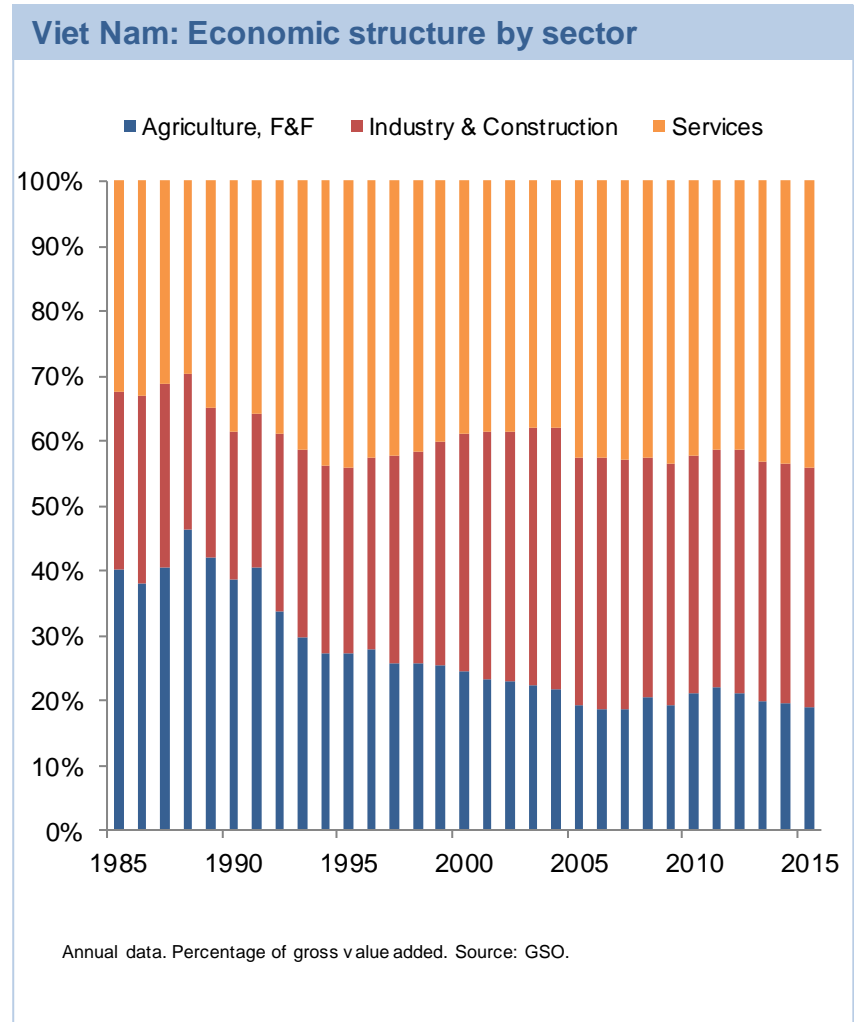
Macroeconomic environment – GDP

Viet Nam vs. ASEAN-4: Annual GDP growth



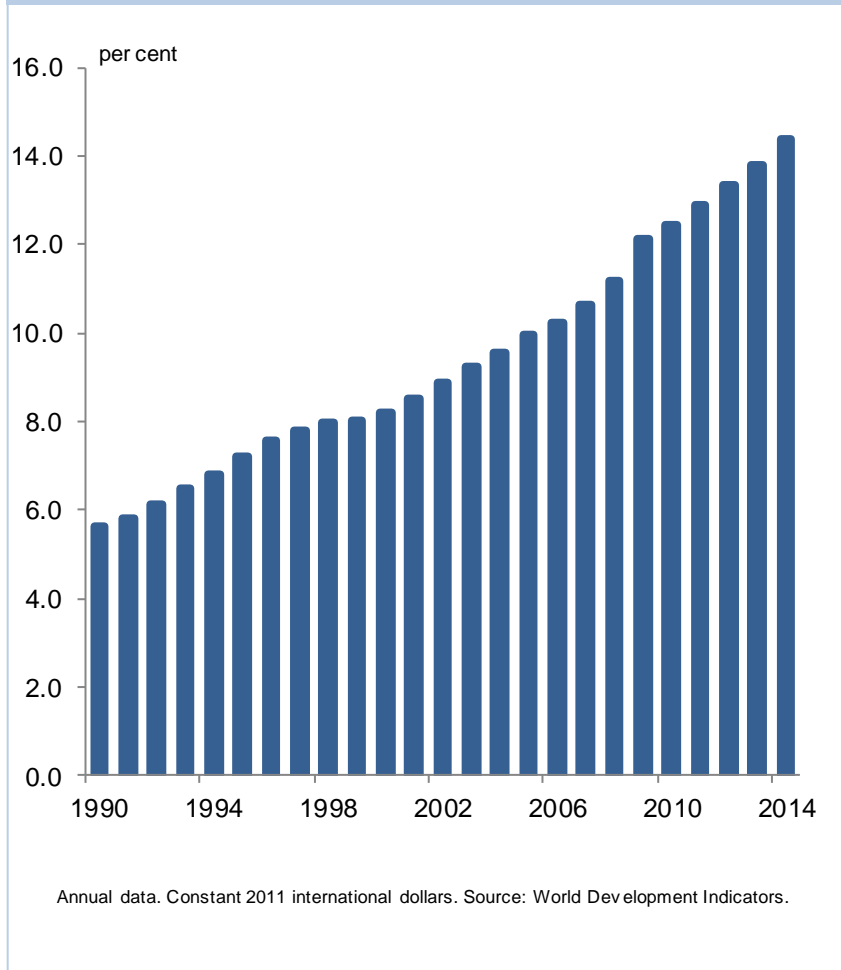
- Output growth has been relatively stable in recent years hovering around 6 per cent
- Fallout from GFC was much less pronounced compared to the Asian crisis in the late 90's
- Recent pick-up in growth above historical average; in a turbulent global economy, output expanded by 6.7 per cent in 2015

- Ongoing structural change of the economy: industry and services now account for roughly 80 per cent of GVA (1990: 60 per cent)
- Although agriculture has lost importance in terms of output, it still accounts for nearly half of employment
- Rebalancing has come to a halt with the economic structure remaining largely unchanged since 2005

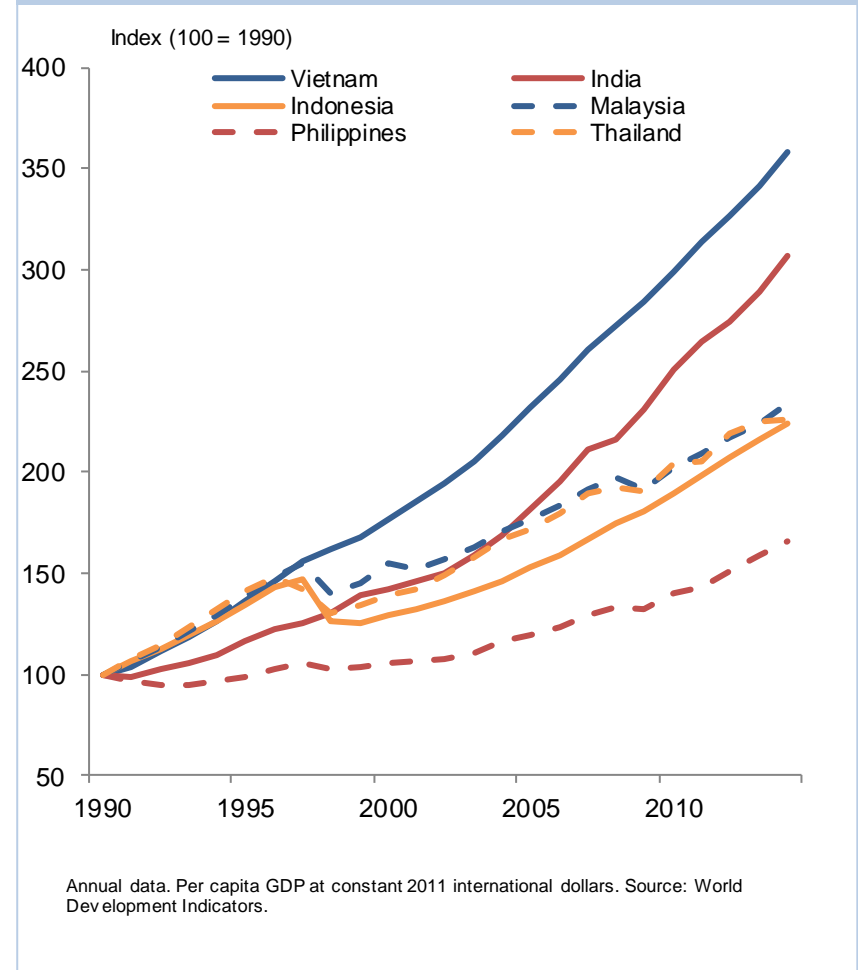


Macroeconomic environment – GDP

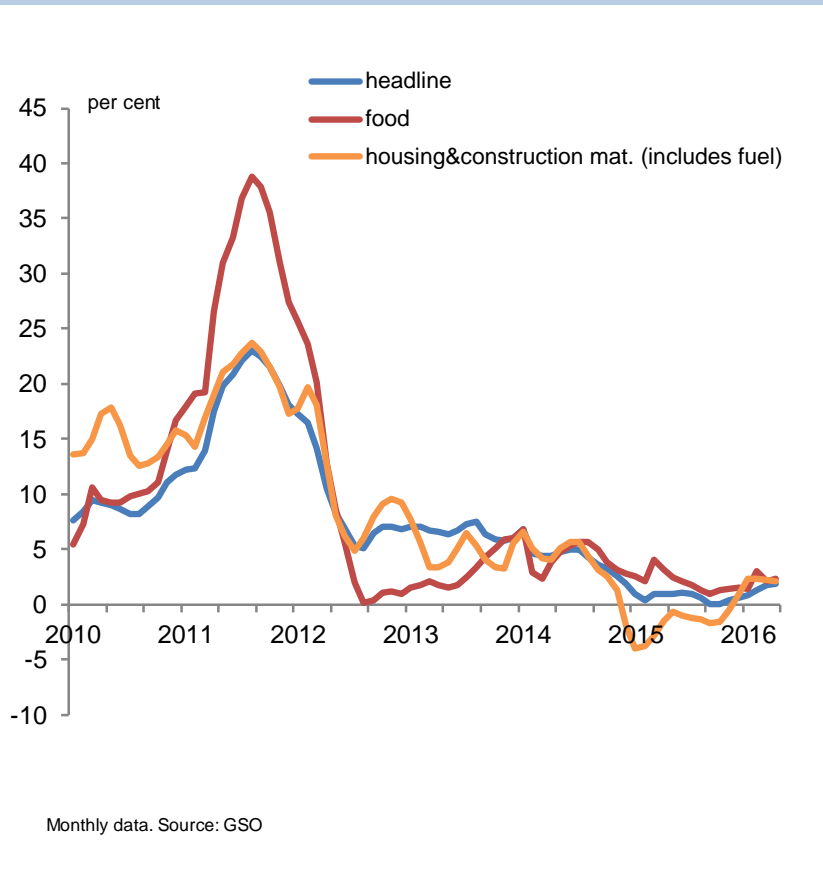
Viet Nam: GDP per capita, relative to OECD average



Viet Nam: International comparison

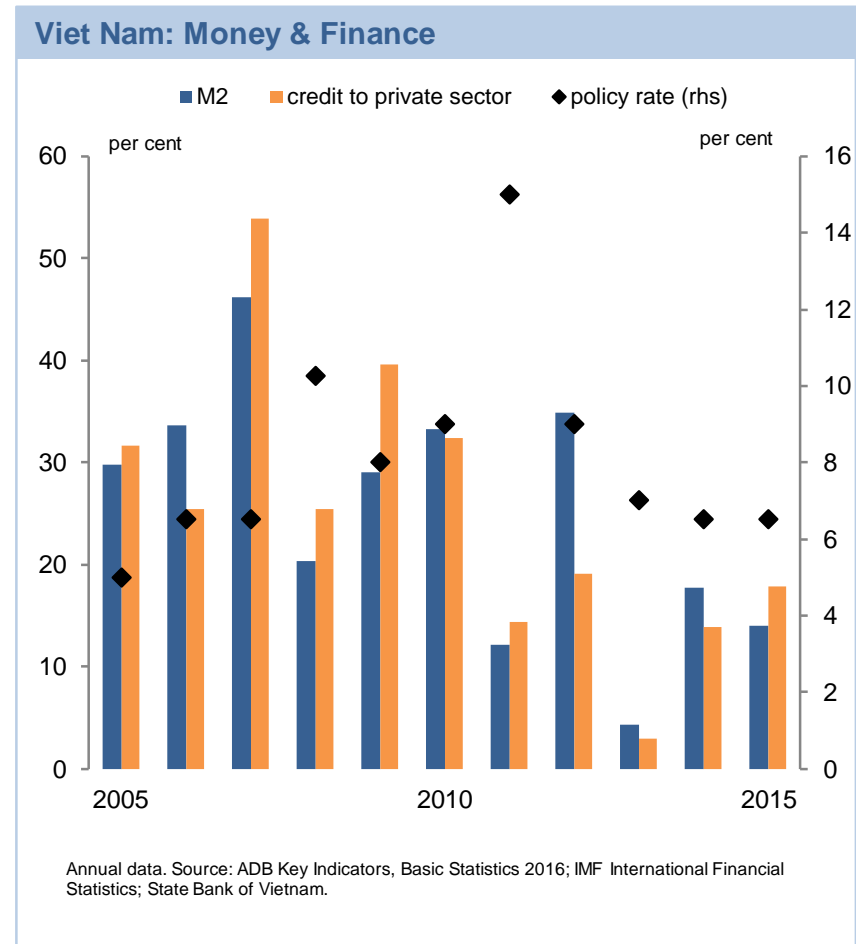


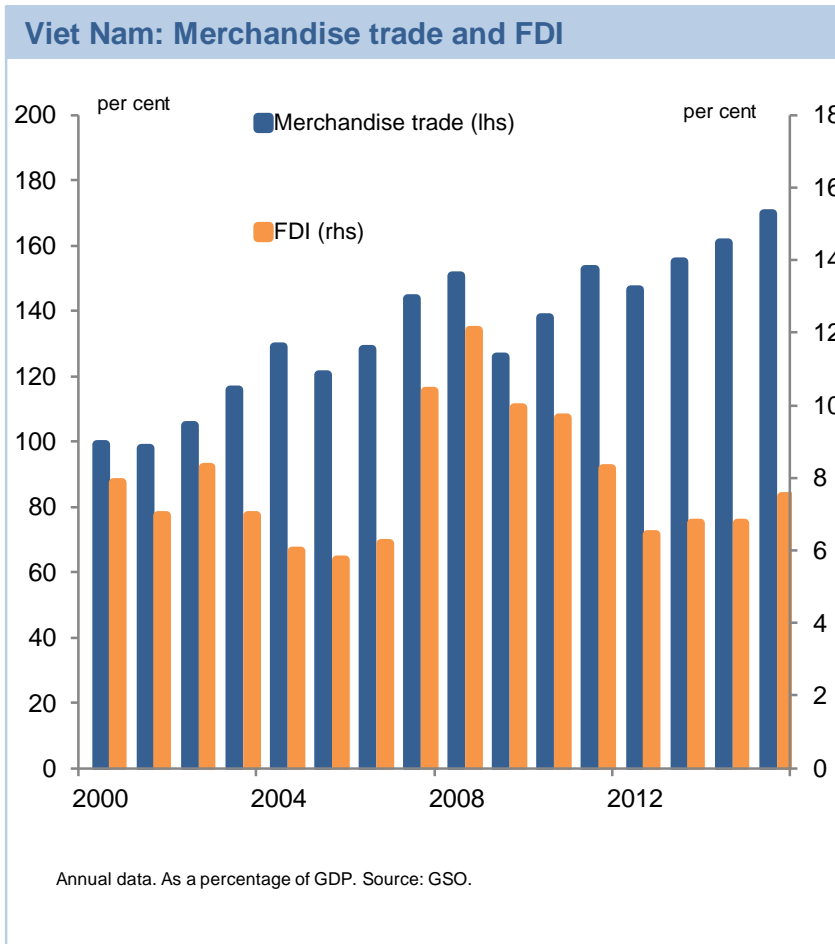
Viet Nam: Consumer price inflation



- By historical standards, consumer price inflation has been moderate
- Cheaper food and fuel were largely responsible (food and housing and construction materials account for nearly half of the goods basket)
- Core inflation has been hovering around 2 per cent since mid 2015

- Money & credit growth have been robust in the past two years
- As a share of GDP, credit to the private sector stands at over 100 per cent of GDP (in 2015: Δ 10 ppt)
- Real lending rates have been below 5 per cent until last year. Set to drop again as inflation picks up

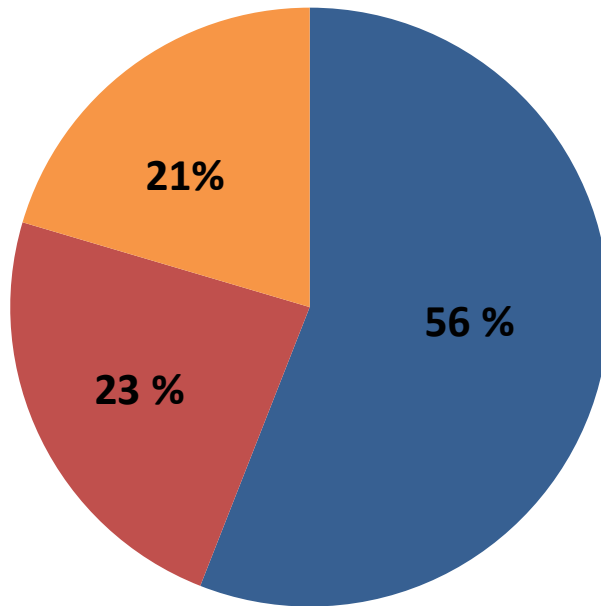




- Well integrated into global supply chains
- Merchandise trade as a fraction of GDP has nearly doubled since 2000
- Ratio of FDI inflows to GDP is among the highest in the region

Viet Nam: FDI by kind of activity

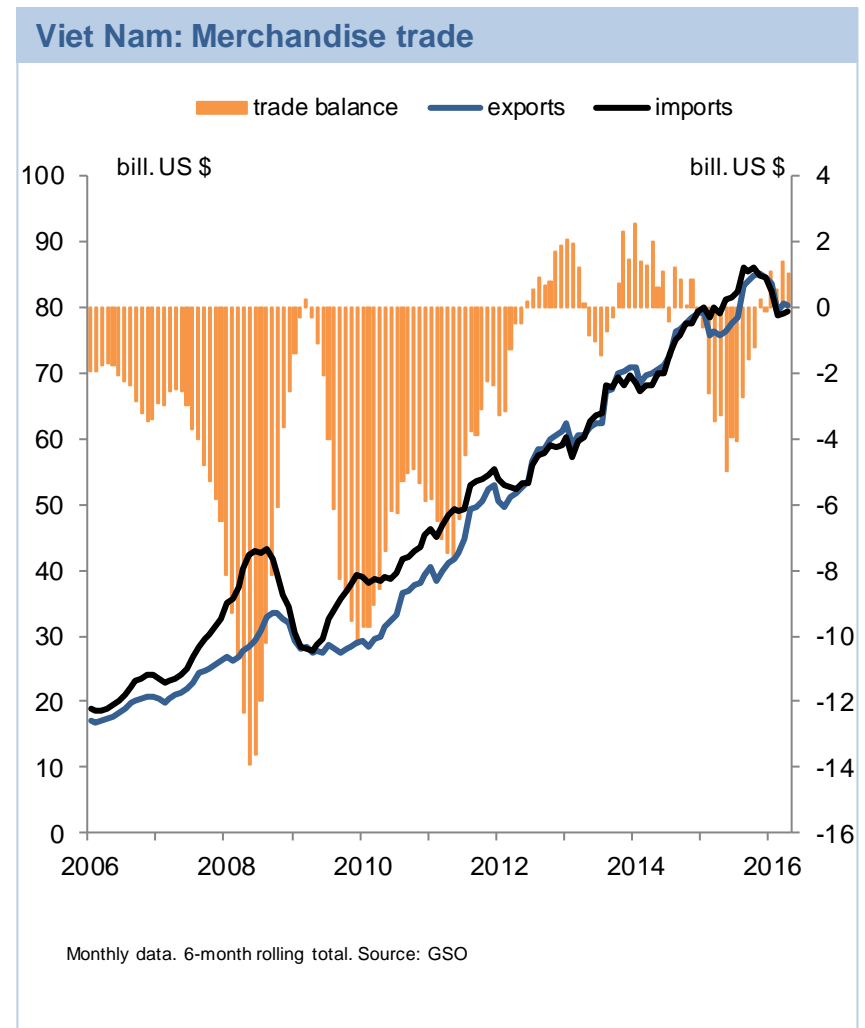
■ Manufacturing ■ Real estate & construction ■ other



Annual data. Cumulated FDI until 31.12.2013. Source: GSO

- FDI activity has been concentrated in the manufacturing sector
- Geographically, largest player South Korea (Samsung)
- Asian nations in total account for roughly 85 per cent of FDI -> reflects integration into regional supply chains

- Trade balance briefly went into deficit in 2015
- Buoyed by robust domestic demand imports expanded 11 per cent y-o-y in US\$ (2014: 12.3 per cent)
- Exports weakened substantially growing by 7.9 per cent y-o-y compared to 12.6 per cent 2014



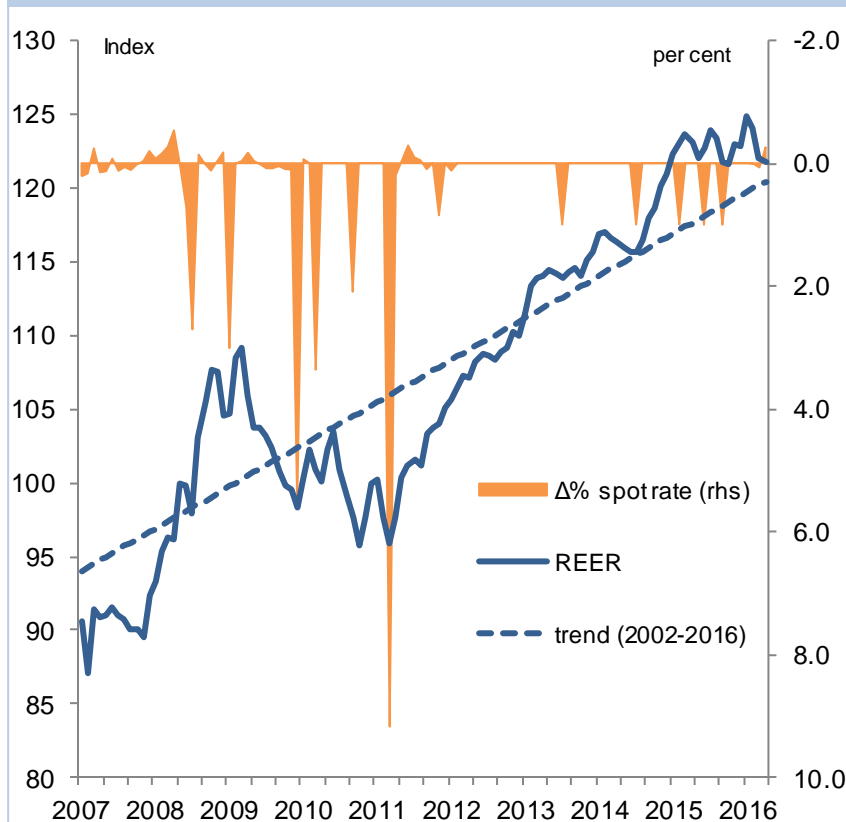
Macroeconomic environment – external sector

	2013				2014				2015				2016
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
total exports	19.2	14.6	15.8	16.8	12.2	15.7	11.9	10.8	9.0	9.3	9.4	4.4	6.4
cashew nut	0.0	0.0	0.4	0.2	0.2	0.3	0.1	0.2	0.2	0.4	0.4	0.3	0.1
cassava & products	0.3	-0.8	-0.3	0.0	-0.3	0.1	0.2	0.1	0.3	0.4	-0.1	0.0	-0.4
chemicals & chemical products	0.5	0.1	0.2	0.3	0.4	0.4	0.3	0.2	0.1	0.0	0.0	0.0	-0.1
coal	0.0	-0.3	-0.5	-0.2	-0.2	-0.4	-0.1	-0.4	-0.4	-0.2	-0.1	-0.2	-0.2
coffee	-0.2	-1.3	-0.4	-1.0	0.5	0.9	0.3	0.4	-1.3	-0.9	-0.1	-0.1	0.2
crude oil	0.4	-1.0	-2.8	0.1	-0.4	2.2	0.9	-1.7	-2.2	-3.9	-2.9	-1.6	-1.2
electric wires & cables	-0.2	0.0	0.0	0.1	0.1	0.1	0.0	0.1	0.1	0.0	0.1	0.0	0.0
computers	3.0	2.4	3.3	1.5	-0.5	-0.3	-0.2	2.8	4.1	3.9	2.9	0.8	0.4
gasoline & kerosine	-0.9	-0.7	-0.3	-0.2	0.0	-0.2	-0.4	-0.3	-0.6	-0.1	0.2	0.0	0.1
handbags, suitcases & others	0.3	0.4	0.4	0.5	0.6	0.5	0.5	0.3	0.3	0.3	0.2	0.2	0.1
machine tools	0.0	0.1	0.5	0.9	1.2	1.3	0.9	0.9	0.8	0.4	0.5	0.8	0.8
pepper	0.2	0.1	0.2	0.0	0.3	0.6	0.0	0.0	0.1	-0.1	0.0	0.2	0.0
plastic products	0.2	0.2	0.2	0.2	0.3	0.2	0.1	0.1	0.0	0.1	0.1	0.0	0.1
porcelains & ceramics	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0
carpet goods	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
rice	0.2	-0.6	-1.0	-0.8	-0.1	-0.1	0.1	0.2	-0.5	-0.1	-0.4	0.5	0.5
rubber	-0.5	-0.4	-0.2	-0.1	-0.7	-0.4	-0.6	-0.6	-0.1	0.0	-0.2	-0.2	0.0
sea food	-0.3	0.2	0.9	1.5	1.4	0.9	0.7	0.1	-0.9	-0.7	-0.8	-0.7	0.1
shoes	1.0	0.9	1.1	1.3	1.3	1.4	1.7	1.3	1.3	1.5	0.8	0.9	0.5
tea	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
textile	2.1	1.9	3.3	3.2	2.2	2.1	2.8	1.6	1.3	1.6	1.5	1.0	0.6
valuable stones & metals	1.8	0.2	0.0	-0.1	-1.5	0.0	0.1	0.0	0.0	0.0	-0.1	0.0	0.0
vegetables	0.1	0.2	0.2	0.0	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.3	0.6
wood & wood products	0.6	0.5	0.6	1.3	0.9	0.5	0.3	0.1	0.3	0.6	0.7	0.7	0.0
telephones	6.8	10.2	6.6	5.3	3.4	1.9	0.5	1.7	3.8	4.5	6.9	2.0	4.4
other	3.9	2.3	3.3	2.6	3.1	3.2	3.1	3.7	2.1	1.4	-0.4	-0.4	-0.2

Macroeconomic environment – external sector

	2013				2014				2015				2016
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
total imports	20.2	18.1	15.9	19.0	10.4	10.5	13.5	14.6	19.7	13.7	11.6	2.1	-4.1
automobiles & motorbikes	-0.5	0.0	0.3	0.5	0.4	0.5	1.0	1.4	1.7	2.6	1.2	1.0	0.0
cattle feed & supplies	1.0	0.6	0.7	-0.2	-0.2	0.3	0.2	0.3	0.7	-0.1	-0.2	0.2	-0.6
chemicals & chemical products	0.8	0.3	0.6	0.9	0.6	0.5	0.9	0.3	0.1	0.3	-0.2	-0.2	0.0
cotton	0.3	0.2	0.3	0.2	0.2	0.5	0.1	0.1	0.1	0.0	0.3	0.0	0.1
electronics & computers	6.1	4.6	4.1	2.1	0.2	-0.5	0.4	3.1	4.2	3.9	3.2	1.0	2.0
fabrics	1.0	1.4	1.3	1.4	1.0	1.2	0.6	0.6	0.5	0.5	0.5	0.3	0.1
fertilizer & insecticides	0.4	0.5	0.0	0.1	-0.1	-0.5	-0.3	-0.4	0.0	0.2	-0.1	0.2	-0.1
liquified gas	-0.1	0.1	-0.2	0.3	0.1	0.2	0.2	-0.1	0.0	-0.2	-0.3	-0.1	0.0
machine tools	2.2	1.8	2.0	4.4	3.3	3.2	4.2	3.8	7.2	3.6	2.0	0.5	-3.0
medicaments	0.3	0.0	0.2	0.1	0.0	0.1	0.0	0.2	0.1	0.1	0.3	0.3	0.3
milk & dairy products	-0.1	0.0	0.2	0.3	0.1	0.2	0.0	-0.1	-0.1	-0.2	-0.2	-0.1	0.0
steel & other metals	0.8	1.4	0.7	0.7	0.1	0.0	2.2	2.4	1.0	1.0	0.7	-0.9	0.4
plastic & plastic products	1.3	1.5	1.4	1.7	1.0	1.0	1.1	0.7	0.2	0.1	0.1	0.0	0.1
paper	0.1	0.1	0.1	0.3	0.1	0.0	0.1	0.0	0.0	0.0	0.0	-0.1	0.0
petroleum & other oil products	-1.6	-2.9	-1.9	-0.1	1.1	0.9	0.5	-1.3	-1.7	-1.5	-1.9	-0.1	-1.6
yarn & other raw materials for textiles	0.4	0.9	0.9	0.5	0.9	0.9	0.8	0.7	0.3	0.2	0.2	0.0	0.0
vegetable & animal fats	0.0	-0.3	-0.1	0.3	0.3	0.3	0.2	-0.2	-0.2	-0.3	-0.2	0.0	-0.1
wheat	-0.5	-0.1	-0.1	0.2	0.2	0.0	0.1	-0.1	0.0	0.0	0.0	-0.1	0.1
wood and materials	-0.1	0.0	0.2	0.8	0.8	1.0	0.3	-0.2	-0.1	-0.3	0.0	0.0	-0.2
other	8.4	8.0	5.1	4.1	-0.3	0.3	0.4	3.4	5.5	3.7	5.9	0.2	-1.3

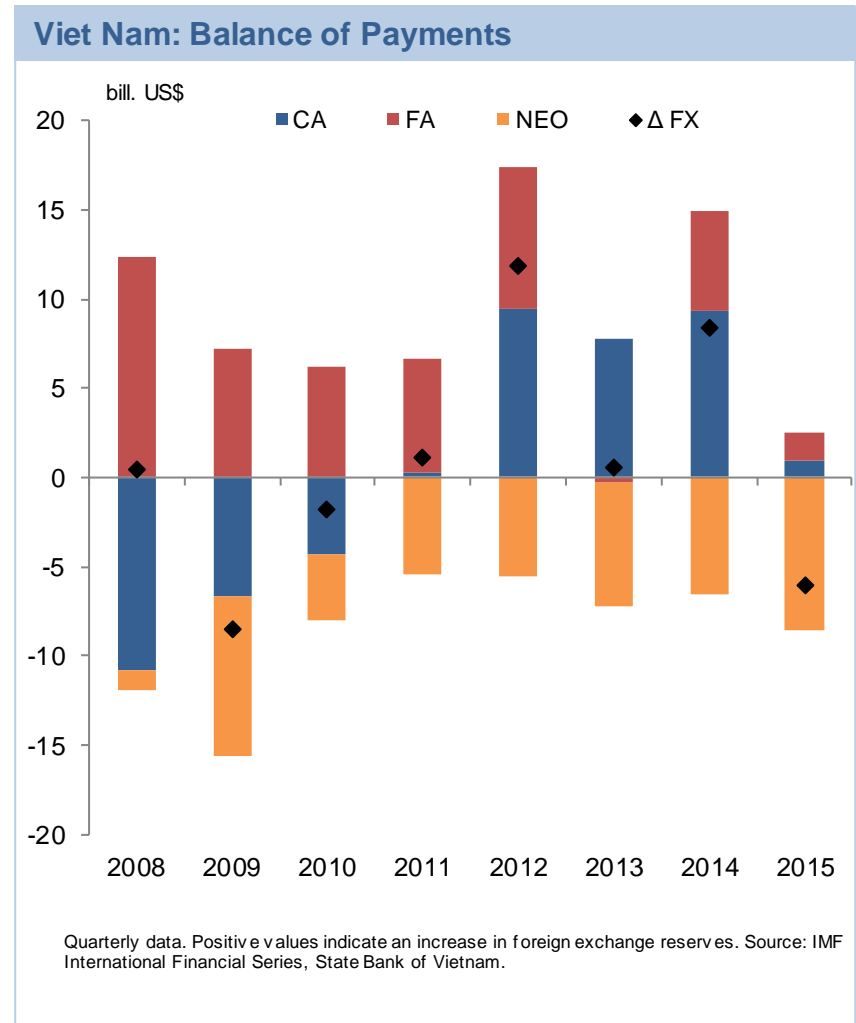
Viet Nam: Exchange rates



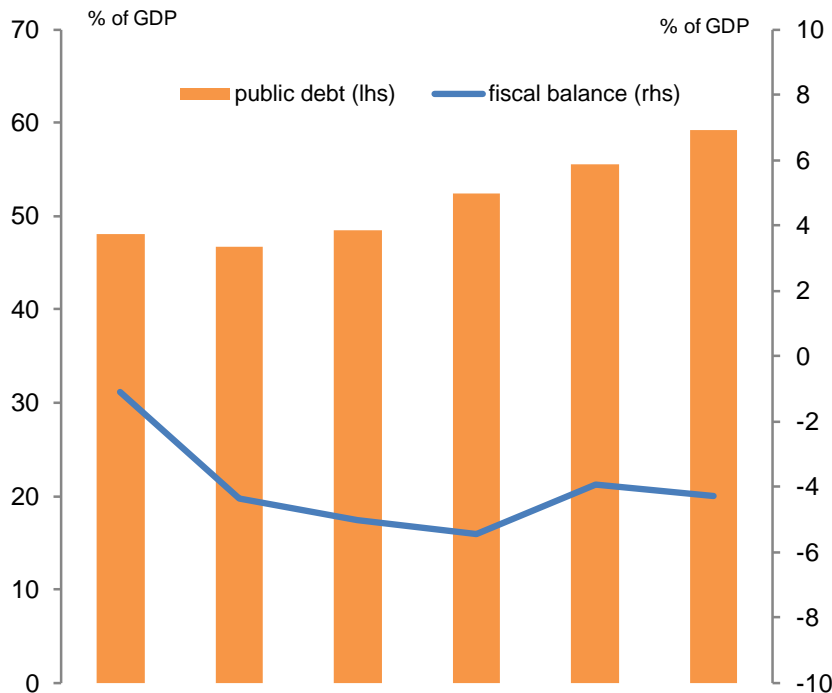
Monthly data. Source: JP Morgan, State Bank of Vietnam.

- VND has been depreciated by roughly 3 per cent in 2015 (eop)
- All things considered, a modest decline compared to other emerging economies
- Compared to its long-run trend, the real effective exchange rate looks less overvalued than in previous years.

- Current account surplus has narrowed due to rising imports.
- Remittances were also a bit weaker ($\Delta 2$ \$ bn).
- Direct investment remained solid (net inflows of 10 \$ bn)
- Strong outflow of capital towards the end of the year
- Large NEO position: net capital outflows and a loss of FX reserves



Viet Nam: Public finances



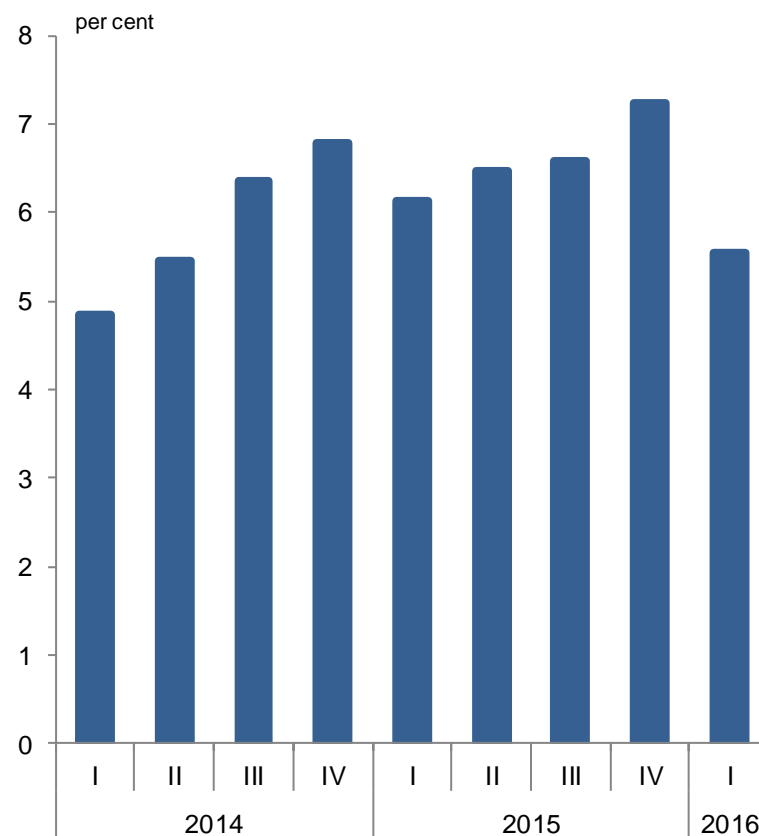
Annual data. As a percentage of GDP. Source: GSO, IMF World Economic Outlook April 2016

- Fiscal balance has improved in last two years but is still in deficit. Lower oil revenues partly contributed to the set-back in 2015
- Public debt has increased to reach nearly 60 per cent of GDP
- Fiscal policy will have to be adjusted to ensure sustainability of public finances

Current developments

- GDP growth took an unexpected dive in the first quarter of 2016, dropping to 5.6 per cent y-o-y (Q4 2015: 7.2)
- Weaker agricultural activity (-2.7 per cent y-o-y) due to adverse weather conditions; decline in M&Q (-0.9 per cent) also played a role
- April data suggest that weakness in agriculture could persist in Q2
- Manufacturing remains robust (9.6 per cent y-o-y in April) and business confidence largely unchanged from previous quarter

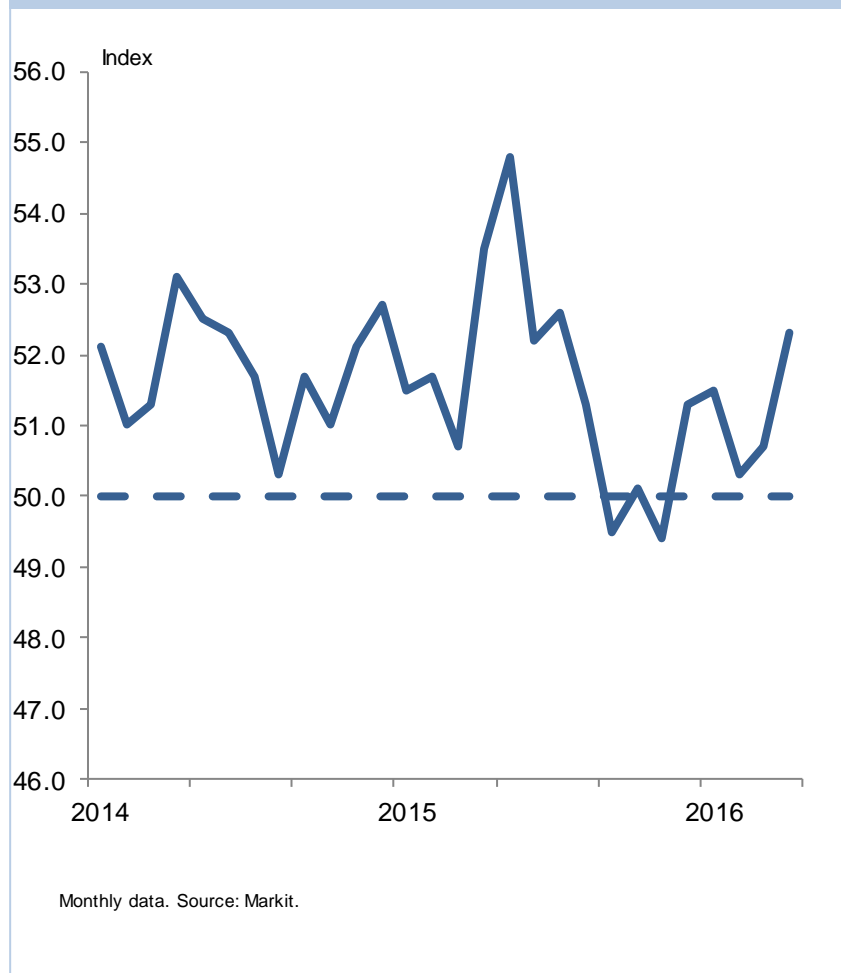
Viet Nam: Quarterly GDP



Quarterly data. At constant 2010 prices. Source: GSO

Current developments

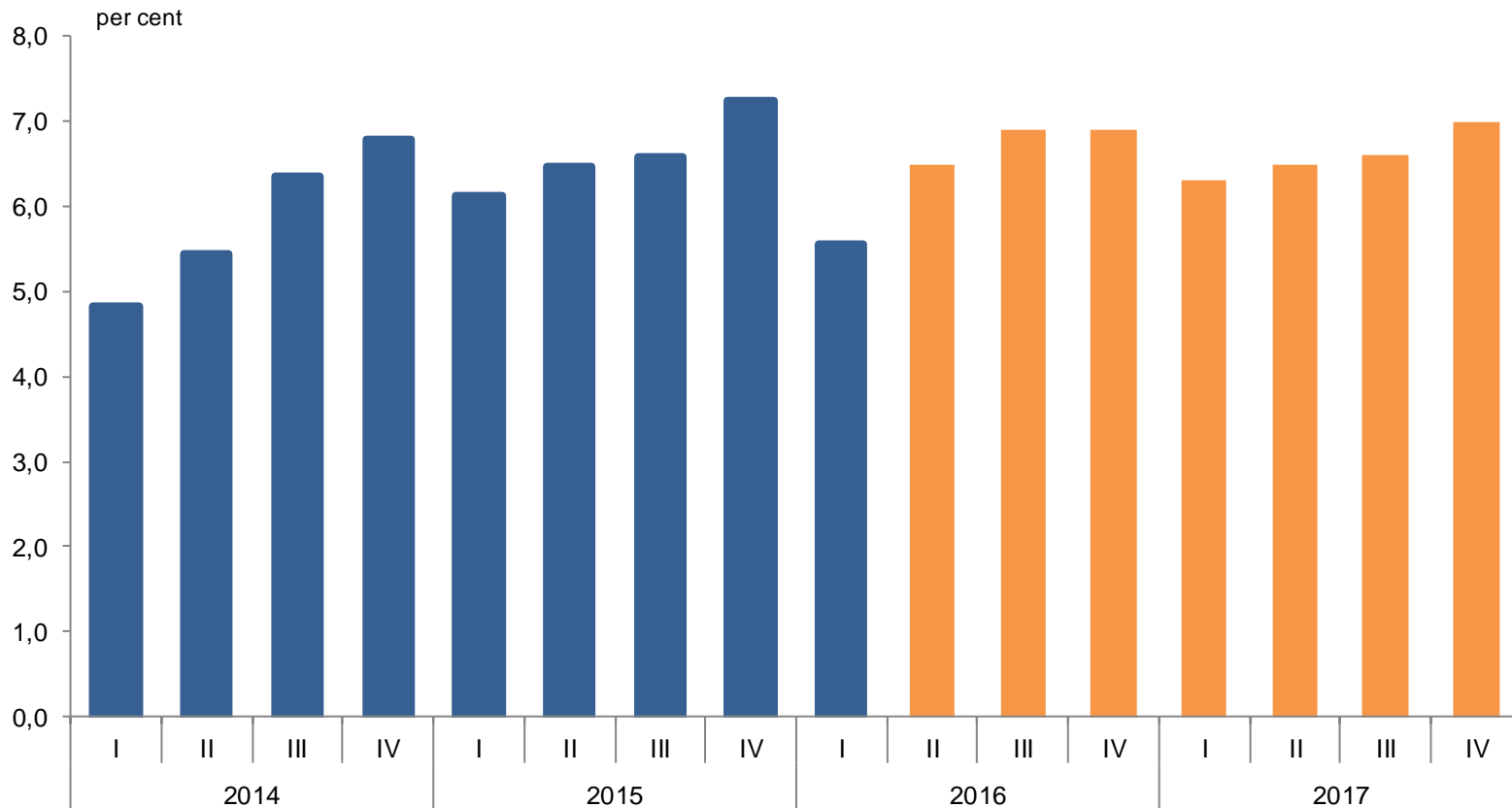
Viet Nam: Nikkei Purchasing Managers Index



- Nikkei PMI has been above 50-point threshold marking expansion since the end of 2015
- This indicator is widely followed by markets for early indications of how the economy is doing
- BUT: for Vietnam, correlation with growth is quite weak

- Robust growth between 6.5-7 per cent in the near-term -> strengthening US recovery should provide further boosts to exports
- China slowdown will weigh on regional growth. BUT: in an uncertain global economy, ASEAN region has generally held up remarkably well
- The current account balance is expected to decline further and stabilize close to zero
- Inflation will pick up over the coming year as base effect from cheaper oil fades out, while remaining in single digits
- Fiscal deficits are forecast to shrink – partly due to rebounding oil prices and consolidation efforts - while remaining substantial

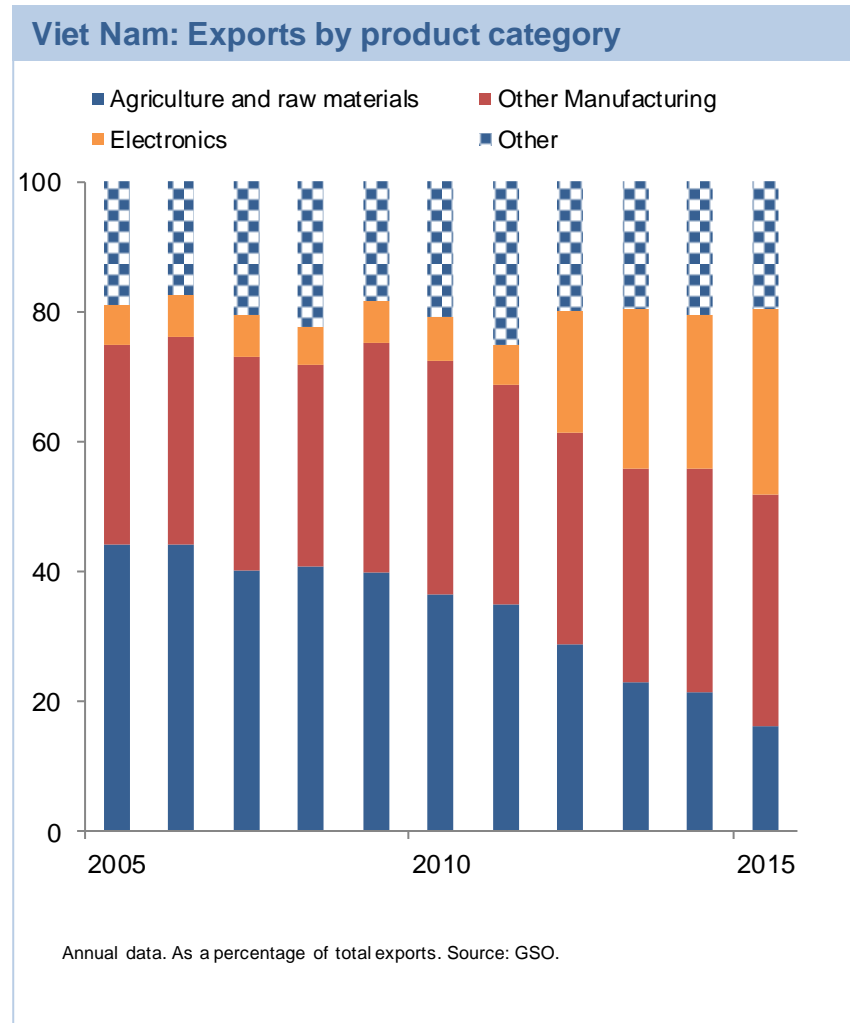
Viet Nam: Real GDP growth & consensus forecasts



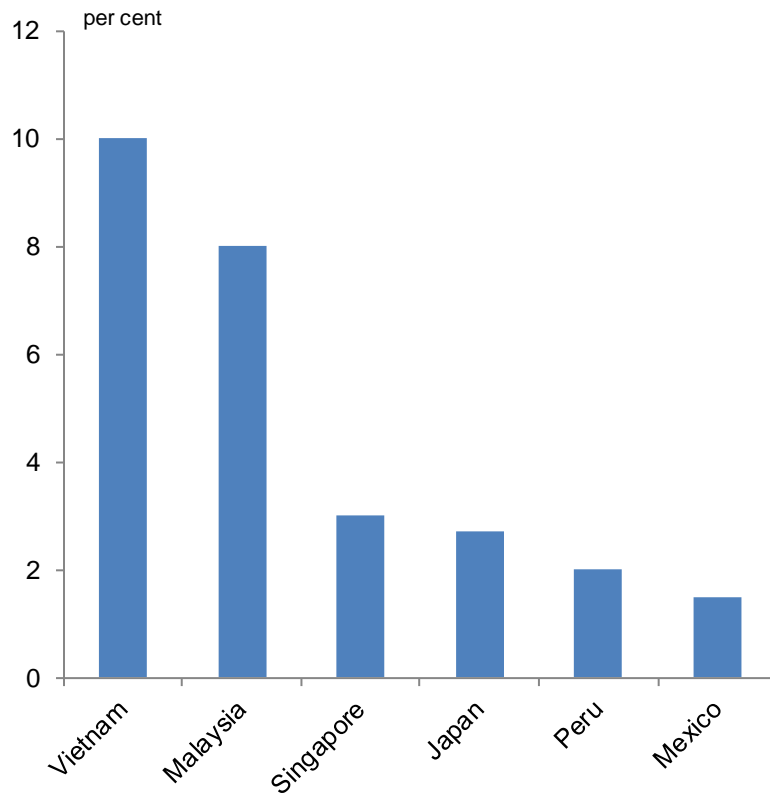
Quarterly data. Constant 2010 prices. Source: GSO, Focus Economics

Risks and opportunities

- On the whole, the Vietnamese economy is more resilient to external shocks
- Exports have become more diversified - both in terms of products as well as destinations
- Simultaneously, domestic demand has been buoyant placing growth on a broader footing



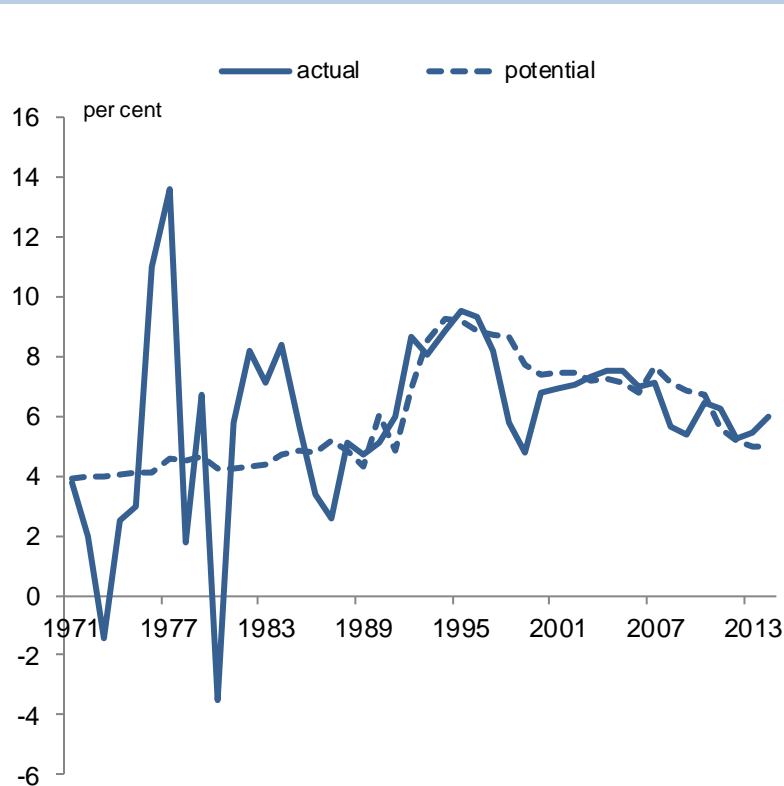
Viet Nam: Potential benefits of TPP



Percentage deviation of real GDP from baseline. Source: World Bank Global Economic Prospects, January 2016

- Viet Nam stands to be one of the main beneficiaries of TPP
- Estimates of the potential gains range from 8 to 10 per cent of GDP by 2030 (World Bank and PIIE, respectively)
- Benefits will unfold as tariffs are liberalized gradually
- However, modifications to the deal (US elections) might dampen positive effects

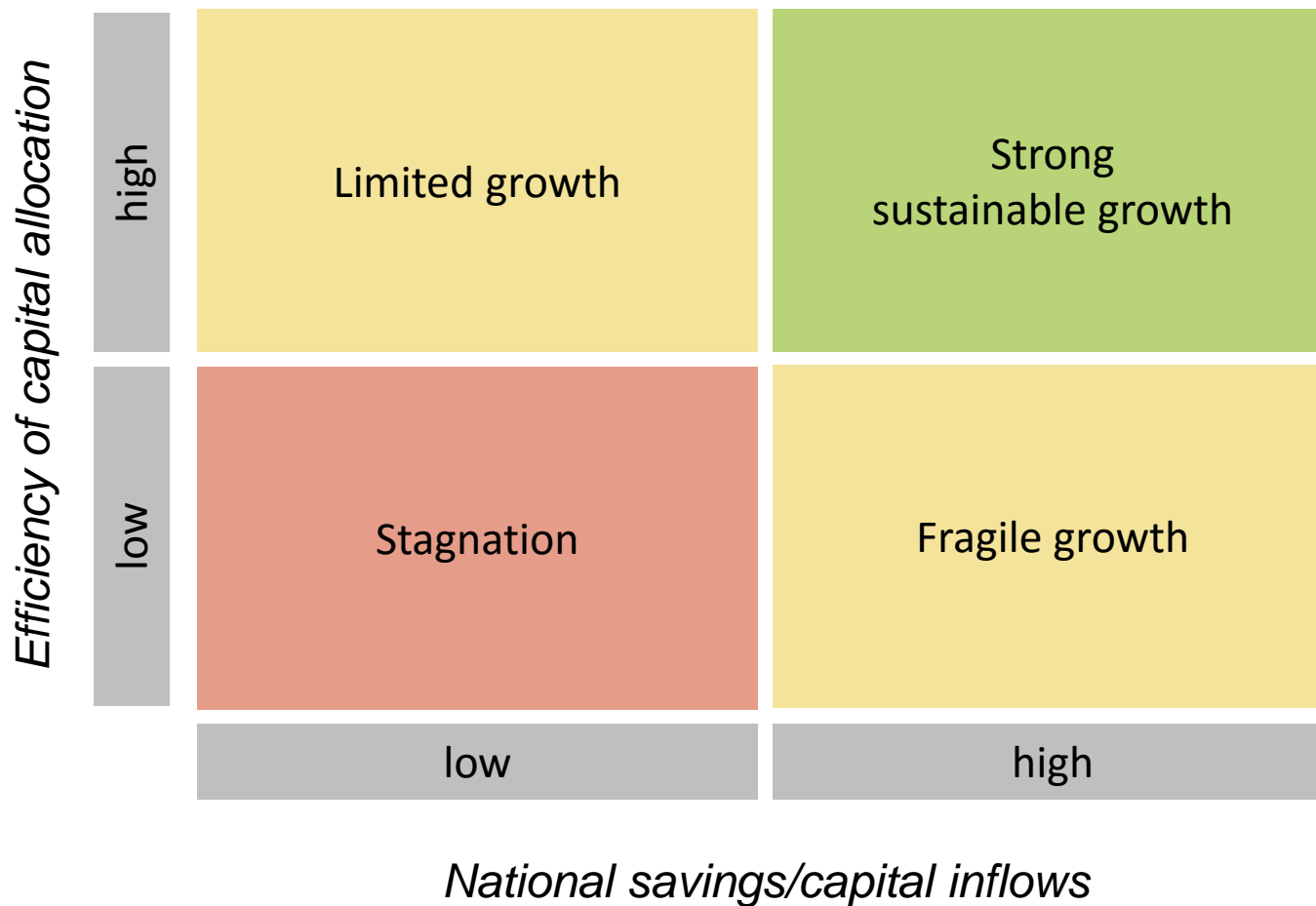
Viet Nam: Actual and potential output growth



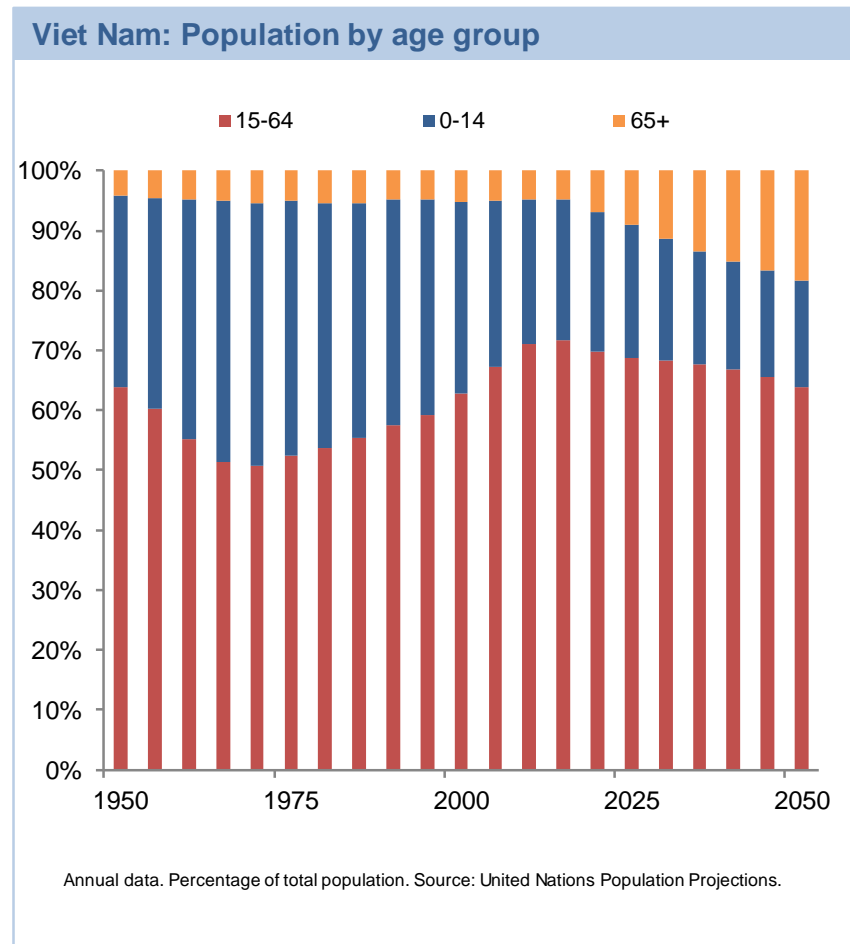
Annual data. Potential output estimates based on the methodology described in Burns et al. (2014) "Estimating potential output in developing countries" Journal of Policy Modeling. Source: GSO, United Nations, World Development Indicators.

- Slowing potential growth: decline of roughly 2 per cent since GFC
- Part of a broader trend in Developing Asia (ADB, 2016)
- The region faced a similar drop in potential growth rates. However, on average it remains at a higher level (around 6.5 per cent)

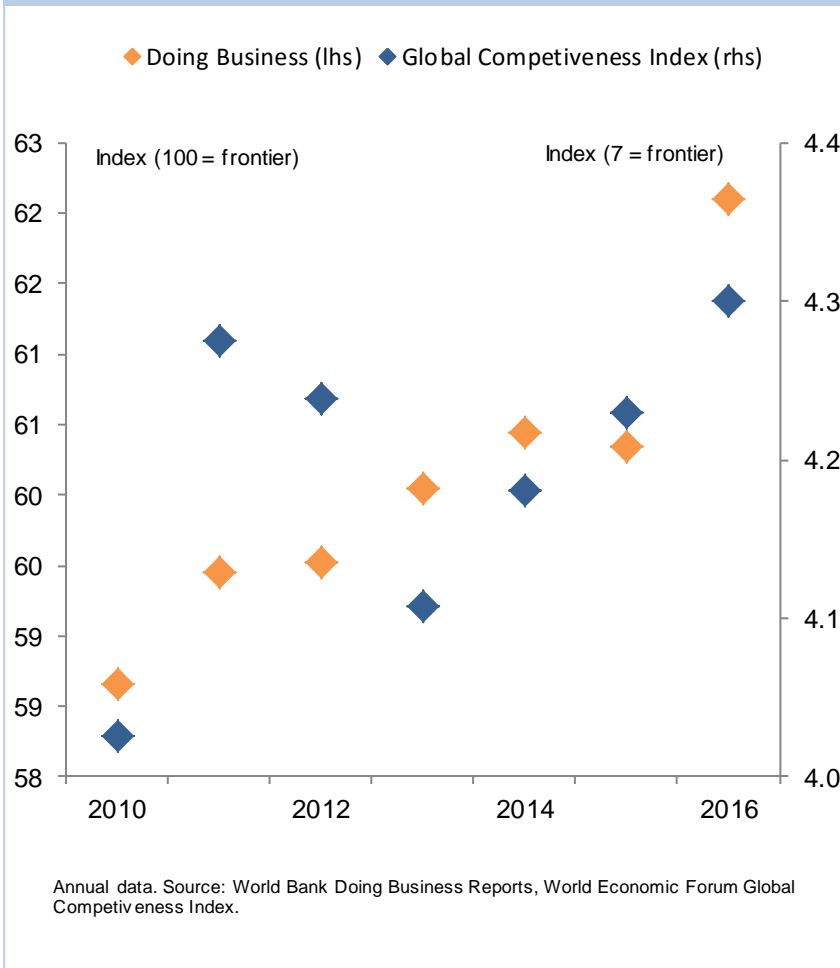
Risks and opportunities



- Growth of working age population is expected to level off -> „Fading out of the demographic dividend“
- ADB estimates that slower labor force growth translates into a one-for-one decline in potential growth
- This highlights the need for structural reforms to boost TFP and potential



Viet Nam: Capturing Distance-to-Frontier



- A useful concept in this context is **frontier potential growth**
- Obvious problem: hard to quantify!
- WB and WEF results are not always consistent
- Can still be useful as a guide to policy

Risks and opportunities

- We identify two imminent threats to macroeconomic stability in the short-term
- **Low level of FX reserves** and indications of capital outflows
- **High and rising levels of public debt** which crowds out private activity and limits fiscal policy space

Viet Nam: FX reserves import coverage



Monthly data. Foreign exchange reserves in months of imports. Source: IMF International Financial Series, GSO

- All in all, the Vietnamese economy appears in quite solid shape and should continue to expand at around 6 per cent over the coming years
- Global headwinds such as the slowdown in China will partially be offset by a strong recovery in advanced economies and increased integration into global markets (TPP et alii)
- Notwithstanding the generally bright outlook, there are risks both to **macroeconomic stability in the short run** and **potential growth in the medium- to long-term**

- In the short-term, high and rising levels of public debt call for fiscal consolidation
- Simultaneously, a shortage of FX reserves threatens to undermine confidence and domestic activity. However, further exchange rate flexibility might not be the first best solution given the degree of openness of the Vietnamese economy
- More generally, a current account deficit is per se not a bad thing. It depends on how it is financed (short- vs. long term) and what is done with the capital imports (investment vs. consumption)
- Economic policy remains highly accommodative. However, with the economy growing firmly, policy will have to be tightened to avoid distortions and regain policy space for the future.

- In the long-run, to sustain rapid growth and avoid the so-called Middle Income Trap, potential output needs to keep up
- As the „demographic dividend“ fades out, boosting productivity will be key
- High share of agriculture in total employment suggests further gains from sectoral reallocation are possible
- Furthermore, by allowing markets to play a greater role, opening up more sectors to FDI and improving institutions and access to frontier technologies, TFP growth can be elevated
- In this context, allowing the financial system to efficiently allocate capital to its most productive use is essential

- There is no dichotomy between short- and long-term goals!
- Macroeconomic stability can be considered a prerequisite for sustained potential growth
 - » Stabilizing expectations and reducing investment uncertainty as well as avoiding economic distortions that can take years to unwind
 - » Likewise, measures that enhance potential growth can act to stabilize output (e.g. by attracting FDI)
- Fundamental institutional framework?
 - » Policy-making: rules vs. discretion
 - » Role of the state vs. the private sector
 - » Structural change and competition

- Evaluate the scope for **short-term forecasting models**
- So-called „nowcasting“ models allow for a timely assessment of business cycle conditions and lay the foundations for adequate economic policy
- Crucial question in any emerging economy such as Viet Nam: are there limits to data availability and how stable are economic relationships?
- Perfunctory analysis by the Kiel Institute suggests that data accessibility rather than availability may be an issue while structural stability can only be assessed empirically. We can offer to look into the usefulness of such models and – if feasible – implement them in close cooperation with staff at ministries or the central bank

- Build a **small-scale forecasting and policy-analysis model**
- Based on the model outlined in Dazziolo and Schmittman (2015, IMF Working Paper 273)
- Technical assistance in implementing the model as well as extensions to tailor it to the specific characteristics of the Vietnamese economy, e.g. explicit modelling of the agricultural sector and a more detailed external sector to account for the high degree of openness
- Assist and train your staff in using the model as well as – perhaps most importantly – highlight the limits of such models

- Implement a framework for **public debt sustainability analysis**
- In accordance with international standards, this procedure allows for an assessment of the evolution of public debt under baseline assumptions
- Analyze the implications of adverse „shocks“ - such as a sudden decline in growth, a rise in real interest rates or an exchange rate depreciation – on the sustainability of public debt and the design of fiscal policy
- The basic framework is relatively simple which makes the analysis transparent and easily understandable („not a bug but a feature“). However, with detailed input from your side, the procedure can be tailored to your specific needs

- Explore the **implications of the Middle Income Trap literature** for the Vietnamese economy
- There is an abundance of explanations to this phenomenon in the academic literature (some scholars deny it even exists!)
- Usual suspects are: demography, inefficient financial sector, quality of infrastructure/human capital/institutions, et alii -> importance of individual factors naturally varies from country to country
- Drawing on our academic experience, produce a case-study investigating which factor are particularly relevant to the development prospects of Viet Nam. We could do this in close cooperation with researchers from academia or research institutes in Viet Nam

- Evaluate, compliment and extend your existing methodologies on estimating **potential output growth**
- Arguably, the foundation for macroeconomic stability in the medium- to long-term requires robust estimates of potential output
- There exists a variety of approaches that deal with some of the data limitations faced in emerging economies. Different models, however, have different advantages (and disadvantages)
- Staff discussion on how your existing models can be extended or improved drawing on our knowledge of the literature and practical experience in modelling and estimating potential output

- Set up a **country risk monitoring database**
- The basic idea is that monitoring certain variables (e.g. credit growth, house prices, fiscal and/or current account balance, FX reserves) can signal rising risks to the economy and allow for timely policy response
- Usually, these models set off alarms when variables cross a threshold that have been associated with crisis periods in the past
- Again, in most emerging economies this is not necessarily feasible due to severe data limitations. However, based on previous work that the Kiel Institute has done in this area, we could calibrate threshold for certain variables based on historical developments in other countries

- **DIWAX: a software for macroeconomic analysis integrated into national accounts frameworks**
 - » Adaptive interfaces for integrating multiple and diverse data sources
 - » Information at your fingertip
 - » Supports experts in the iterative-analytic approach to forecasting
 - » Consistency checks and reporting tools

- Platform for designing customized analytic tools (country monitoring)

- Identify **training needs** and provide **contacts with experts**
- In discussions with members of your staff, we can identify areas of potential improvement and put you in touch with international experts (e.g. statistical offices, government agencies, organizations such as the World Free Zones Association)
- A distinguishing feature of all of the projects outlined above would be our focus on „capacity building“
- Providing connections with experts in fields where specific technical knowledge is required and that we cannot provide (e.g. high tech agriculture) drawing on the Kiel Institute’s network and experience



Prof. Dr. Stefan Kooths is the head of the forecasting center at the Kiel Institute for the World Economy and a professor of economics at the Business and Information Technology School in Berlin. He has over 10 years of experience in the forecasting and policy-consulting business and is a frequent commentator in the German media.



Philipp Hauber is a researcher at the Kiel Institute's forecasting center and monitors the US economy as well as emerging markets. Prior to this, he worked as an economist at Oxford Economics. His PhD focuses on macroeconometrics and forecasting techniques.

Contact: philipp.hauber@ifw-kiel.de

Tel +49-431-8814 245

Mobile +49-162-8656468

Institut
für Weltwirtschaft



Institute
for the World Economy

