



INTERNATIONAL MONETARY FUND
Representative Office for Vietnam and Lao PDR

August 8, 2014

Mr. Tomoyuki Kimura
Country Director
ADB Vietnam Resident Mission
23 Phan Chu Trinh Street
Hanoi, Vietnam

Dear Mr. Kimura:

I refer to Mr. Nugent's letter of May 16, 2014 requesting an Assessment Letter to the ADB Proposed Program Loan to the Socialist Republic of Vietnam.

Please find attached the Assessment Letter which has been issued to the IMF Executive Board. Please kindly note that the letter cannot be included in any documents intended for publication.

With warm regards,

A handwritten signature in blue ink that reads "Sanjay".

Sanjay Kalra
Resident Representative

cc. Mr. Rhee
Mr. Nelmes

VIETNAM—ASSESSMENT LETTER FOR THE ASIAN DEVELOPMENT BANK

August 6, 2014

Recent Developments and Outlook¹

1. **Economic performance improved over the last year.** Growth is recovering, underpinned by robust exports and foreign direct investment (FDI), while domestic activity remains subdued, reflecting weaker demand, slow progress in state owned enterprise (SOE) reform, and weakened banks. Inflation eased to mid single digits, substantially lower than a few years ago. The external current account remains in surplus and gross international reserves increased. Banking system liquidity improved, and steps toward bank restructuring are underway, including individual bank restructuring plans, nonperforming loan (NPL) purchases by the Vietnam Asset Management Company (VAMC), and the piloting of a new risk management regulation based on Basle II. However, full implementation of a tighter prudential regulation for asset classification and provisioning has been delayed, and progress in non-performing loan resolution and bank recapitalization has been slow. SOE reform is moving forward, albeit gradually, with restructuring plans, amendments to the legal framework and equitization.

2. **For 2014, real GDP is projected to grow 5½ percent, with inflation around 5¼ percent.** The current account is expected to remain in surplus, and reserves to reach around 2½ months of imports of goods and services. Public debt is projected to reach 55 percent of GDP, allowing little fiscal space to address critical expenditures and potential costs of banking and SOE reform. The gradual pace of bank reform raises vulnerability to adverse shocks and negative macro-financial feedback, which could further undermine growth and add significantly to public debt, particularly if fiscal consolidation is delayed. The economy is also vulnerable to external shocks including surges in global financial volatility, slower trading partner growth and regional geopolitical tensions. Early conclusion to key trade negotiations would secure access to main export markets, spur market-based reforms, and provide an upside to the growth outlook.

Macroeconomic Policies

3. **Fiscal consolidation is needed to create space for critical expenditures and possible contingent liabilities from bank and SOE reform, and address risks.** Continuing recent loose fiscal policy, the 2014 budget deficit is expected to rise to around 6½ percent of GDP (GFS 2001) with expenditure restraint more than offset by lower revenue. A growth-friendly consolidation to return public debt to around 45 percent of GDP in the medium term

¹ The 2014 Article IV consultation was concluded by the IMF's Executive Board on July 30, 2014.

would require raising revenue to safeguard social spending and well-targeted capital expenditures. This is achievable with a strategy to broaden the tax base, improve administration, forego further tax rate reductions, and institutionalize SOE dividend payments to the budget. There is also space to rationalize public expenditure, including broader civil service reforms that raise efficiency and address the large public wage bill.

4. **The monetary policy framework should gradually shift from the exchange rate to inflation as the nominal anchor.** With output below estimated potential, current supportive monetary conditions are appropriate as long as inflation pressures remain muted. Greater exchange rate flexibility would help buffer shocks and facilitate further accumulation of reserves. Preparing the groundwork for moving toward inflation as a nominal anchor will be crucial for a successful transition. Initial steps include promoting a deep and liquid foreign exchange market, establishing an interest rate instrument, improving liquidity forecasting and management, and gearing policy communications toward price stability.

5. **A more comprehensive approach to bank restructuring is critical to reduce macro-financial risks and restore robust sustainable economic growth.** While progress has been made in a number of areas, reliance on de facto forbearance and liquidity leaves the system susceptible to adverse shocks against which banks would not be adequately provisioned. This is compounded by a high risk of contagion brought about by cross-ownership among banks, and between banks and enterprises. A more expeditious recognition of losses on NPLs, restructuring of viable banks, and an orderly exit of insolvent institutions would improve confidence, restore credit flows and improve monetary policy transmission. Important steps include: diagnostic assessments of banks under stricter prudential norms; recapitalization, including through greater foreign participation and use of public funds under strict conditions for systemically important institutions; elimination of forbearance and continued strengthening of supervision; legal reforms to facilitate NPL resolution; and strengthening the VAMC with equity capital and the ability to buy and sell NPLs at market value. A stronger crisis management framework should also be pursued.

6. **Accelerating SOE reform will reduce risks and support growth by improving the allocation of resources.** While the authorities have made progress, further efforts are needed to accelerate implementation and improve coordination of the reform agenda, which is fragmented over different agencies and ministries. It will be important that efforts go beyond partial equitization and focus on strengthening corporate governance and ensuring a level playing field for all corporate enterprises.

Vietnam: Selected Economic Indicators, 2009–15 1/							
	2009	2010	2011	2012	Est. 2013	Projections	
						2014	2015
Output							
Real GDP (percent change)	5.4	6.4	6.2	5.2	5.4	5.5	5.6
Prices (percent change)							
CPI (period average)	6.7	9.2	18.7	9.1	6.6	5.2	5.2
CPI (end of period)	6.5	11.7	18.1	6.8	6.0	5.3	5.0
Core inflation (end of period)	6.6	9.8	14.3	9.6	6.4	...	...
GDP deflator	6.2	12.1	21.3	10.9	4.8	6.4	6.2
General government finances (in percent of GDP) 2/							
Revenue and grants	25.6	27.3	25.9	22.6	22.9	20.3	20.1
<i>Of which: Oil revenue</i>	3.4	3.2	4.0	3.8	3.4	2.6	2.3
Expenditure	31.6	30.0	26.9	29.4	28.5	26.9	26.2
Expense	19.3	19.2	18.4	20.4	21.3	20.4	20.2
Net acquisition of nonfinancial assets	12.3	10.8	8.6	9.0	7.2	6.5	6.1
Net lending (+)/borrowing(-) 3/	-6.0	-2.8	-1.1	-6.8	-5.6	-6.6	-6.1
Public and publicly guaranteed debt (end of period)	46.9	48.4	46.7	48.5	51.6	54.8	57.1
Money and credit (percent change, end of period)							
Broad money (M2)	29.0	33.3	12.1	18.5	18.8	18.1	15.7
Credit to the economy	39.6	32.4	14.3	8.7	12.7	12.0	12.2
Interest rates (in percent, end of period)							
Nominal three-month deposit rate (households)	10.7	11.6	14.9	9.4	8.3	...	...
Nominal short-term lending rate (less than one year)	12.7	14.0	16.4	12.9	12.4	...	...
Balance of payments (in percent of GDP, unless otherwise indicated)							
Current account balance (including official transfers)	-6.5	-3.8	0.2	6.0	5.6	4.1	3.4
Exports f.o.b.	56.2	64.1	72.0	73.6	77.5	79.7	80.2
Imports f.o.b.	63.7	68.6	72.3	68.0	72.4	76.4	77.3
Capital and financial account	6.6	5.5	4.8	5.6	-0.1	2.3	1.9
Gross international reserves (in billions of U.S. dollars) 4/	14.1	12.4	13.5	25.4	26.0	38.0	48.8
In months of prospective GNFS imports	1.9	1.4	1.4	2.3	2.0	2.6	3.1
Total external debt (end of period)	38.0	38.8	38.8	38.0	38.5	38.1	38.3
Nominal exchange rate (dong/U.S. dollar, end of period)	18,479	19,498	21,035	20,825	21,105	...	...
Nominal effective exchange rate (end of period)	80.8	81.1	68.2	67.9	70.1	...	...
Real effective exchange rate (end of period)	116.0	117.4	122.5	127.5	136.1	...	...
Memorandum items:							
GDP (in trillions of dong at current market prices)	1,809	2,158	2,780	3,245	3,584	4,024	4,513
GDP (in billions of U.S. dollars)	101.6	112.8	134.6	155.6	170.6	187.8	204.5
Per capita GDP (in U.S. dollars)	1,181	1,297	1,532	1,753	1,902	2,073	2,233
Sources: Vietnamese authorities; and IMF staff estimates and projections.							
1/ The national accounts has been re-based to 2010 from 1994 by the authorities.							
2/ Follows the format of the <i>Government Finance Statistics Manual 2001</i> .							
3/ Excludes net lending of the Vietnam Development Bank.							
4/ Excludes government deposits.							