AMRO Annual Consultation Report

Vietnam - 2018

The ASEAN+3 Macroeconomic Research Office (AMRO)

September 2019

Acknowledgements

1. This Annual Consultation Report on Vietnam has been prepared in accordance with the functions of AMRO to monitor, assess and report to its member macroeconomic status and financial soundness and to identify the relevant risks and vulnerabilities, and assist them in the timely formulation of policy recommendation to mitigate such risks (Article 3(a) and (b) of AMRO Agreement).

2. This Report is drafted on the basis of the Annual Consultation Visit of AMRO to Vietnam from 8 to 17 January 2019 (Article 5 (b) of AMRO Agreement). The AMRO Mission team was headed by Dr. Seung Hyun (Luke) Hong (Group Head and Lead Specialist). Members include Dr. Jade Vichyanond (Desk Economist for Vietnam), Dr. Nguyen Thi Kim Cuc (Senior Economist and Back-up Economist for Vietnam); Dr. Jinho Choi (Senior Specialist and Back-up Economist for Vietnam); Mr. Sophak Duong (Associate); Mr. Nguyen Manh Duc (Associate); Ms. Le Phuong Thao (Associate); Mr. Kazuo Kobayashi (Technical Assistance Specialist). AMRO Chief Economist Dr. Hoe Ee Khor and Director Dr. Junhong Chang also participated in the Mission. This AMRO Annual Consultation Report on Vietnam for 2018 was prepared by Dr. Seung Hyun (Luke) Hong and Dr. Jade Vichyanond with contributions from Dr. Nguyen Thi Kim Cuc, Dr. Jinho Choi, Mr. Sophak Duong, Mr. Nguyen Manh Duc, and Ms. Le Phuong Thao; peer-reviewed by Dr. Abdurohman (Specialist) and Dr. Lee Jae Young (Group Head and Lead Economist); and was approved by Dr. Hoe Ee Khor.

3. The analysis in this Report is based on information available up to 28 February 2019.

4. By making any designation of or reference to a particular territory or geographical area, or by using the term “member” or “country” in this Report, AMRO does not intend to make any judgements as to the legal or other status of any territory or area.

5. On behalf of AMRO, the Mission team wishes to thank the Vietnamese authorities for their comments on this Report, as well as their excellent meeting arrangements and hospitality during our visit.

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Executive Summary

Since AMRO's last Annual Consultation Report in 2017, Vietnam's economic growth has strengthened further in 2018. The external position continued to improve, while ongoing consolidation efforts kept public debt in check. Looking ahead, policy focus should be on maintaining macroeconomic and financial stability. Greater exchange rate flexibility with judicious use of foreign exchange intervention to curb excessive volatility is recommended.

1. **The Vietnamese economy continued its robust growth in 2018 and is expected to maintain the strong momentum in 2019.** GDP grew by 7.1 percent in 2018 on the back of strong growth in manufacturing and services. Inflation was relatively low in the first half of 2018 but started to rise in the middle of the year in tandem with higher food and fuel prices. In an attempt to mitigate the inflationary pressure, the government managed the increase of administered prices and postponed the 33-percent increase in environmental protection tax until the beginning of this year. As a result, the average headline inflation in 2018, at 3.5 percent, was kept below the National Assembly's target of 4.0 percent.

2. **Surpluses in both the current account and financial account helped bolster the foreign reserves buffer.** After posting a strong surplus of over 8 percent of GDP in Q1 2018, the current account balance declined in Q2 in tandem with a cyclical moderation in electronic exports. Meanwhile, FDI inflows remained the dominant driver of the financial account surplus. The robust external position was reflected in an accumulation of foreign reserves, which reached USD55 billion at end-2018. The dong depreciated by about 2.1 percent vis-à-vis the USD in 2018, mirroring the downward trend of other regional currencies.

3. **The fiscal deficit widened slightly but remained broadly in line with the medium-term fiscal consolidation plan.** Despite relatively buoyant corporate income tax and VAT collection, total revenue was unchanged, mainly due to lower land-based revenue and trade-related revenue. Expenditure was maintained at the previous year's level, leaving the deficit unchanged, at 3.5 percent of GDP in 2018. The budget deficit is expected to widen slightly to 3.6 percent of GDP in 2019. Public debt declined to 58.4 percent of GDP as of end-2018.

4. **Credit growth moderated significantly in 2018 and was below the SBV's credit growth target, while the SBV continued to tighten its macroprudential stance in an attempt to improve banking sector soundness** The SBV decreased the credit growth target from 18 percent in 2017 to 17 percent in 2018; however, actual credit growth declined more sharply to 14 percent. In part, the credit slowdown may have reflected the SBV's enhancement of its surveillance of banks' lending, especially for real estate and securities investment. In addition, the maximum ratio of short-term funds to medium- and long-term loans was reduced to curb maturity mismatch in the banking system.

5. **The banking system's NPL has remained elevated despite significant progress in NPL resolution by some banks.** As of end-2018, the official NPL ratio, which excludes special VAMC bonds, stood at 1.9 percent, similar to the 2.0 percent as of end-2017. However,

legacy NPL, in the form of special VAMC bonds, was another 3.0 percent of total loans. Meanwhile, the capital-adequacy ratio (CAR) has declined for domestic banks.

6. **Key risks for the real and external sectors stem mainly from rising trade protectionism and increased volatility in capital flows.** The effects of the US-China trade conflict on Vietnamese exports would be transmitted through the global value chain and competition in the domestic and third markets. In addition, slowing global demand amid rising trade protectionism may pose a major challenge to Vietnam's export-led growth strategy. On the positive side, however, the US-China trade tension may benefit Vietnam through trade diversion as well as relocation of production. Meanwhile, policy surprises from central banks in advanced economies could lead to renewed turbulence in asset prices and capital outflows from emerging and frontier markets, which may also affect Vietnam.

7. **Banking sector risks stem from the relatively low capital buffers and unresolved NPL**. Progress has been made to resolve legacy NPL, though it is recommended that further efforts be made to resolve remaining NPL in the banking system. Meanwhile, banks' capital adequacy ratios (CARs) are projected to decrease when the stricter Basel II standards are applied to all banks at the start of 2020.

8. **Increased reliance on less sustainable revenue sources may undermine the fiscal position in the longer term.** Corporate income tax has declined as a share of GDP in recent years, while VAT and non-tax revenue have increased, offsetting the decline. Although the enhanced VAT collection is commendable, the increased dependence on non-tax revenue, such as equitization, poses a concern for the long-term sustainability of revenue sources.

9. **With tighter global financial conditions and strong domestic growth momentum, policy focus should be on maintaining macroeconomic and financial stability.** Consequently, the lowering of the credit growth target in 2019 is prudent, and the SBV's continued supervision of lending to certain sectors in the economy is warranted to mitigate the risk of an asset bubble. Recent progress in resolving legacy NPL in several banks is commendable and further efforts to speed up NPL resolution are strongly encouraged to improve the soundness of the banking system. Regarding the external position, greater exchange rate flexibility with judicious use of foreign exchange intervention to curb excessive volatility is recommended.

10. **AMRO supports the authorities' continued efforts at fiscal consolidation and reform initiatives in line with the medium-term fiscal plan.** AMRO also recommends greater efforts to improve efficiency in the provision of public goods and services while further prioritizing expenditures to promote long-term growth potential. Policy initiative to shift government financing to greater reliance on domestic and longer-term sources will help reduce vulnerability and will be greatly facilitated by domestic capital market development.

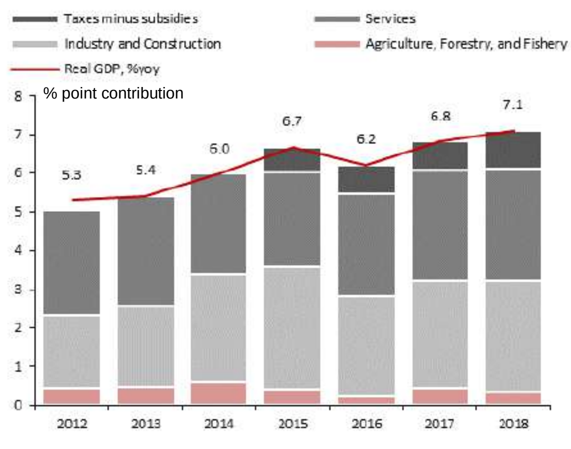
A. Recent Developments and Outlook

A.1 Real Sector

1. **The Vietnamese economy continued its robust growth in 2018 and is expected to maintain the strong momentum in 2019.** GDP grew by 7.1 percent in 2018 on the back of strong growth in manufacturing and services, exceeding the authorities' target growth rate of 6.7 percent (Figure 1). Manufacturing growth was driven by electronic exports, while the services sector was propelled by domestic consumption and boosted by tourism. GDP growth in 2019 is expected to be around 6.6 percent, sustained by vigorous growth in manufacturing and services.

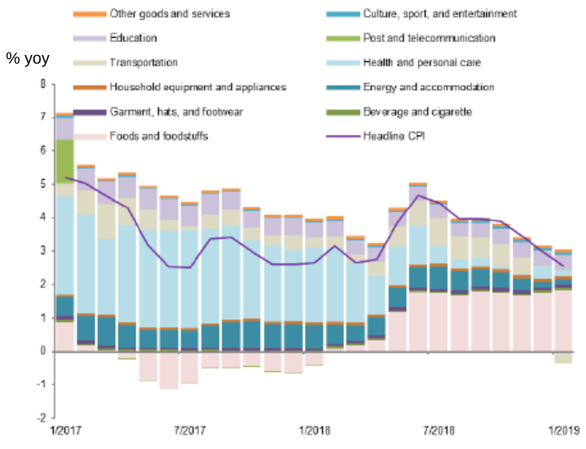
2. **Amid rising headline inflation, management of administered prices has helped dampen inflationary pressure.** Inflation was relatively low in the first half of 2018 but started to rise in the middle of the year in tandem with higher food and fuel prices, reaching 4.7 percent yoy (Figure 2). In an attempt to dampen the inflationary pressure, the government managed the increase of administered prices including the postponement of a 33-percent increase in the environmental protection tax until the beginning of 2019. As a result, the average headline inflation in 2018, at 3.5 percent, was kept below the National Assembly's target of 4.0 percent, while the average core inflation remained low at 1.5 percent. We project headline inflation in 2019 to be around 3.8 percent in light of a likely upward adjustment of electricity tariffs.

Figure 1. GDP growth



Sources: General Statistics Office (GSO), CEIC, and AMRO staff calculations.

Figure 2. CPI inflation



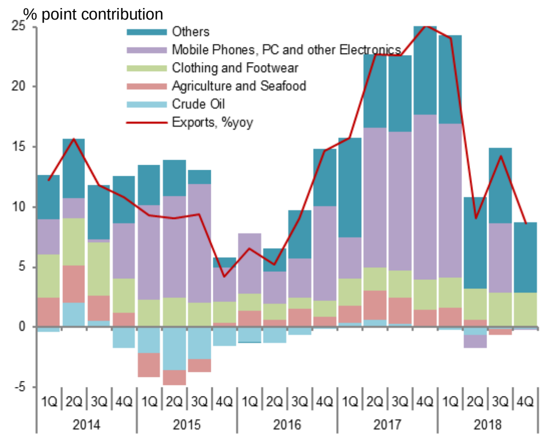
Source: General Statistics Office, CEIC, and AMRO staff calculations

A.2 External Sector

3. **Despite some moderation in growth, exports was relatively robust in 2018 and the trade balance remained in surplus.** Growth in electronic exports slowed slightly in 2018, largely driven by the base effect of the previous year's surge due to the release of new Samsung mobile phone models and strong global semiconductor demand, resulting in total export growth of 13.3 percent in 2018, compared to 21.8 percent in the previous year (Figure

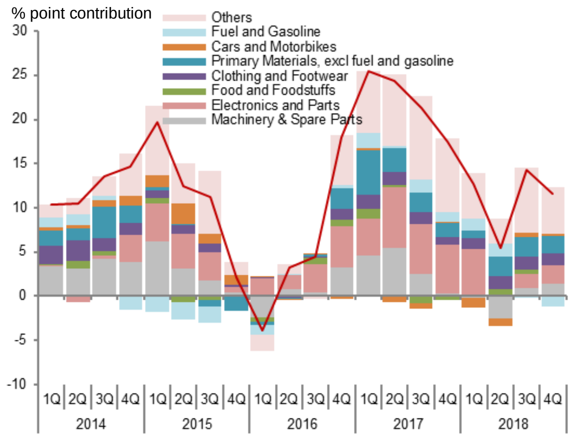
3). Given the export sector's high degree of reliance on imported intermediate goods, import growth also decelerated to 11.2 percent in 2018, down from 21.9 percent the previous year, with the slowdown led largely by imports of electronics and parts (Figure 4). As a result, the trade balance remained in surplus, at USD6.5 billion in 2018.

Figure 3. Exports



Sources: SBV, CEIC, and AMRO staff calculations.

Figure 4. Imports



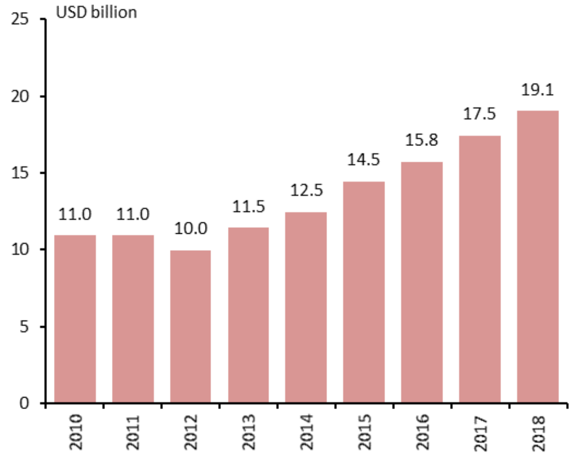
Source: SBV, CEIC, and AMRO staff calculations

4. A positive trade balance and strong remittances helped maintain the current account in surplus. While buoyant profits from multinational companies widened the primary income deficit, and trade-related transportation costs kept the services balance in negative territory, the current account balance remained positive, at USD5.9 billion (ytd) as of Q2 2018, largely on the back of sustained growth in goods exports, tourism revenue, and robust remittance inflows.

5. Reflecting sustained interest from foreign investors, FDI disbursement grew at roughly the same rate in 2018 as in the previous year. FDI disbursement grew by 9.1 percent in 2018 to USD19.1 billion, roughly half of which were channeled into manufacturing activities.[1] FDI in the real estate sector continued to gain ground, as did investment in wholesale and retail trade, reflecting foreign investors' burgeoning interest in the domestic market. In terms of registered FDI, some moderation was experienced in 2018 but this was mainly due to the base effect of the previous year's power generation projects. Korea and Japan remained the largest FDI investors, the two countries accounting for roughly half of registered FDI in 2018.

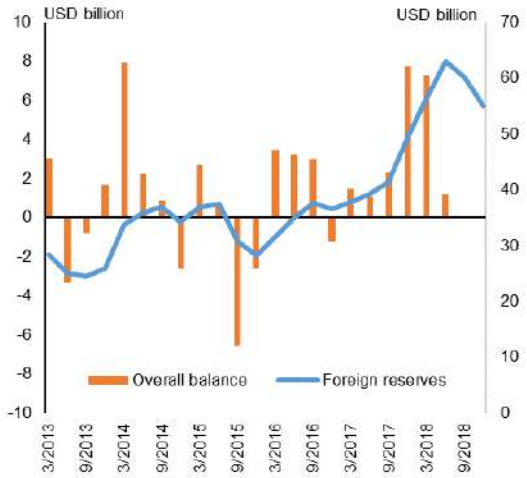
[1] This data is sourced from the Ministry of Planning and Investment, according to which FDI disbursement statistics is derived from information of planned investment submitted by firms. As such, this data may be less accurate than FDI data taken from the SBV's balance of payments statistics—which is based on bank flows—but is often more timely.

Figure 5. Disbursed FDI



Sources: SBV, CEIC, and AMRO Staff Calculations

Figure 6. Gross International Reserves



Sources: SBV, CEIC, and AMRO Staff Calculations

6. **Strong FDI inflows continued to be the backbone of the financial account, which stood at USD8.0 billion (ytd) as of Q2 2018.** Net portfolio investment was largely positive throughout the year, except around mid-year when global financial market volatility increased in light of the US-China trade tension. The heightened volatility was also reflected in a dip in the other investments balance amid downward pressure on regional currencies including the Vietnamese dong.

7. **Surpluses in both the current account and financial account helped bolster the foreign reserves buffer.** The robust external position was reflected in the accumulation of foreign reserves, which increased from USD49 billion at the start of 2018 to USD58 billion at the end of Q2 (Figure 6).[2] However, the dong (as well as other regional currencies) came under downward pressure in the second half of the year, reflecting capital outflows from emerging markets. Foreign exchange intervention helped limit the dong's depreciation to about 2.1 percent vis-à-vis the USD in 2018, less than that of most other regional currencies.

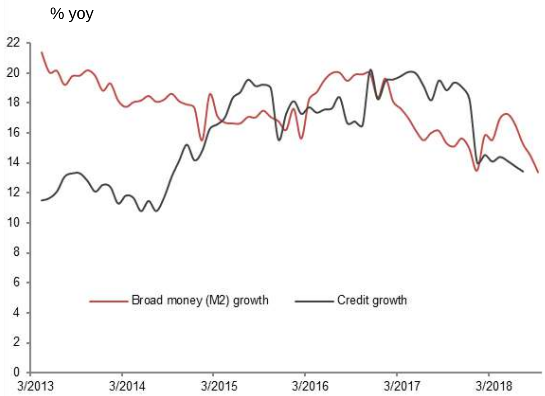
8. **The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) was ratified by Vietnam's National Assembly in November 2018.** The CPTPP trade agreement, which has also been ratified by Australia, Canada, Japan, Mexico, New Zealand, and Singapore, became effective from mid-January this year, and encompasses tariff cuts and reductions in non-tariff barriers, as well as provisions in areas such as services, labor, the environment, and government procurement. Meanwhile, the EU-Vietnam Free Trade Agreement (EVFTA) and the Investment Protection Agreement between Vietnam and the EU (IPA) were officially signed in June this year. Both parties are making efforts to ratify the two agreements by the end of this year.

[2] All data on foreign reserves was from CEIC.

A.3 Monetary Sector and Financial Markets

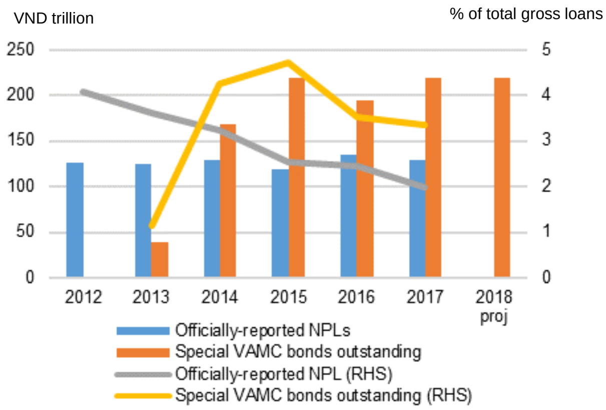
9. Credit growth has moderated, in line with the SBV's lower credit growth target. SBV decreased the target from 18 percent in 2017 to 17 percent in 2018, with a view to safeguarding financial stability. In the event, the banking system's actual credit growth declined from 17 percent in 2017 to 14 percent in 2018, with slower growth recorded across most sectors (Figure 7). Despite more subdued credit growth, monetary conditions remained relatively accommodative, in part thanks to the SBV's lowering of the policy rate for open-market operations from 5 percent to 4.75 percent in January 2018 (see Annex 5: Monetary Policy Instruments in Vietnam).

Figure 7. Broad money and credit growth



Source: State Bank of Vietnam, IMF, CEIC, and AMRO staff calculations

Figure 8. NPL and VAMC bonds



Sources: SBV and VAMC

10. SBV continued to tighten its macroprudential stance in order to improve banking sector soundness. In 2018, the SBV enhanced its surveillance of banks' lending for real estate and securities investment in its ongoing endeavor to reduce the banking system's exposure to high-risk loans. In addition, to reduce maturity mismatch in the banking system, the maximum ratio of short-term funds to medium- and long-term loans was reduced from 50 percent to 45 percent at the beginning of 2018 and again to 40 percent at the beginning of 2019.

11. The banking system's NPL has remained elevated despite significant progress in NPL resolution by some banks. As of end-2018, the official NPL ratio, which excludes special VAMC bonds, stood at 1.9 percent, similar to the 2.0 percent as of end-2017. However, legacy NPL, in the form of special VAMC bonds, constituted another 3.0 percent of total loans[3], with divergence in the progress of legacy NPL resolution across banks. Several banks successfully wrote off NPL after buying them back from the VAMC, while the bulk of legacy NPL, remained concentrated in some banks. Meanwhile, the capital-adequacy ratio (CAR) has declined for all segments of banks, due in part to provisioning. In particular, the CAR for state-owned banks has remained relatively low, albeit slightly higher than the regulatory

[3] AMRO's staff estimate

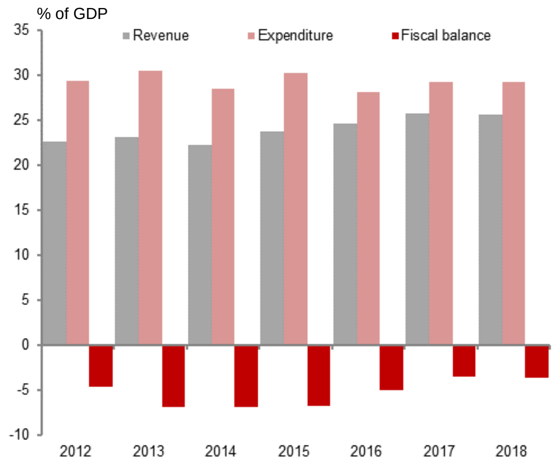
minimum of 9 percent under Basel I. As far as the banking system's profitability is concerned, returns on assets and returns on equity have broadly increased, while liquidity is relatively sufficient and well-managed, with the ratio of short-term funding to medium- and long-term loans brought down to 29 percent as of November 2018 compared to 31 percent in the same period of the previous year.

12. **The real estate market is experiencing an upcycle, fueled by rising interest from foreign buyers.** The price upswing is for the most part driven by landed property and high-end/luxury condominium segments. Meanwhile, heightened bank supervision on real estate lending and a shift away from speculative purchases have kept prices of the mid-end and affordable segments relatively stable. Among challenges faced by the real estate sector are higher land prices, compression of rental yield, and delays in infrastructure development. Compared to the period around 2011 when the real estate market experienced a sharp downturn, the current ratio of the average residential unit price to personal income is lower, suggesting greater affordability and a relatively low likelihood of a bubble of the magnitude experienced in the last real estate boom-bust cycle.

A.4 Fiscal Sector

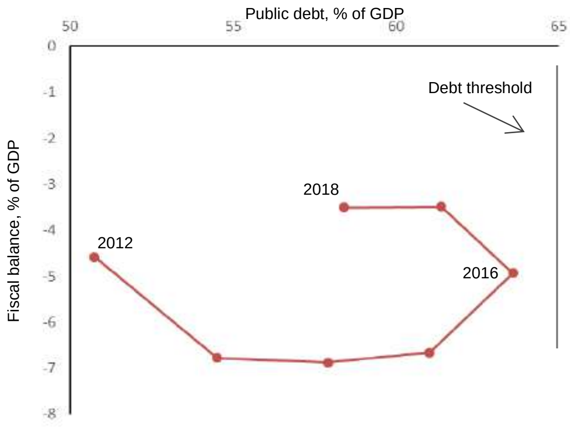
13. **The fiscal deficit widened slightly but remained broadly in line with the medium-term fiscal consolidation plan.** Despite relatively buoyant corporate income tax and VAT collection, total revenue was unchanged, at 25.7 percent of GDP in 2018, mainly due to lower land-based revenue and trade-related revenue (Figure 9). Expenditure was maintained at the previous year's level, leaving the deficit unchanged, at 3.5 percent of GDP (Figure 10).

Figure 9. Fiscal revenue and expenditure



Source: Ministry of Finance, CEIC, and AMRO staff calculations

Figure 10. Fiscal balance and public debt



Source: Ministry of Finance, CEIC, and AMRO staff calculations

14. **The budget deficit is expected to widen slightly to 3.6 percent of GDP in 2019.** Declining land-based revenue and state capital sales are expected to bring revenue down to 22.9 percent of GDP. On the expenditure side, a slowdown in recurrent and capital

expenditure is expected to partially offset the decline in revenue collection, resulting in a deficit of 3.6 percent of GDP. In light of this continued fiscal consolidation drive, public debt declined to 58.4 percent of GDP as of end-2018 and is forecast to decline further to 57.4 percent of GDP in 2019 (see Annex 2: Assessing the Vulnerability of Public Debt in Vietnam).[4,5]

15. No significant change in tax policy is envisioned in the near term. The government increased the environmental production tax by 33 percent at the start of the year. Looking ahead, however, no major revision of tax policy is expected in the coming year. Discussion on the controversial introduction of a property tax is ongoing but may be implemented only after 2019, if at all, after fanning considerable opposition from the public in 2018. The planned increase in the VAT rate, from 10 percent to 12 percent, as well as a decrease in the number of items eligible for special low rates, faced similar resistance, resulting in postponement of any change until after 2019. Meanwhile, the current parameters of CIT and PIT are set to remain unchanged in the near term.

16. Ongoing discussion to revise the Public Investment Law is expected to facilitate expenditure disbursement. When the current State Budget Law became effective in 2017, the law's budget cycle was found to be ill-synchronized with the existing Public Investment Law, leading to delays in fiscal disbursement sometimes; according to the State Budget Law, the state budget is based on both three-year financial plan cycles and five-year socio-economic plan cycles, while the Public Investment Law only stipulates five-year cycles for public investment. The discrepancies are currently under review and are expected to be rectified in a revised Public Investment Law. Furthermore, classification of expenditure categories and funding sources in the above-mentioned laws will be also reviewed and revised to ensure consistency.

17. A ministry-level commission was launched in September to manage a number of large SOEs that were previously under the purview of line ministries. The establishment of the commission, known as Committee for Management of State Capital (CMSC), in September last year, is a commendable step towards developing more efficient and better regulated SOEs. In the past, these SOEs were owned, managed, and regulated by relevant line ministries, giving rise to potential conflicts of interest and compromised performance. The separation of responsibilities, with CMSC tasked with ownership and management and the ministries acting as regulators, should allow for more efficient and professional management by CMSC and more objective regulation by the ministries.

[4] AMRO's estimate

[5] Vietnam's graduation from low-income status to lower-middle-income status is not expected to greatly affect costs of borrowing for the government in the near term. For loans from the World Bank, with the low-income status interest rate around 1.5 percent and the lower-middle-income status interest rate around 4.5 percent, the jump in interest charges is not insignificant. However, there is still roughly USD6 billion of undisbursed loans from the World Bank to be extended over the next six years at the low-income status interest rate. Meanwhile, domestic financing, which is set to gradually overtake external financing, can be secured at interest rates that are low by historical standards.

B. Risks, Vulnerabilities, and Challenges

B.1 Global Trade Tension

18. Key risks for the real and external sectors stem mainly from rising trade protectionism. Despite running a trade surplus with the US, Vietnam seems unlikely to be singled out for protectionist measures by the US.[6] Meanwhile, the effects of the US-China trade conflict on Vietnamese exports would be through the global value chain, i.e. Vietnamese exports of intermediate goods to China, and competition in the domestic and third markets. As China is forced to seek market opportunities outside the US, Vietnam's domestic industries may face greater competition from Chinese goods, as would Vietnamese exporters to third-country markets. In addition, slowing global demand amid rising trade protectionism may pose a substantial challenge to Vietnam's export-led growth strategy (see Annex 4: Evolution of Vietnam's export structure and the impact of global shocks on Vietnam). On the positive side, however, the US-China trade tension may benefit Vietnam through trade substitution as well as relocation of production from China to Vietnam to avoid the US tariffs. Furthermore, there may be an offsetting factor in the CPTPP, which became effective beginning of this year and has the potential to expand Vietnam's market access.

B.2 Uncertain Global Financial Conditions

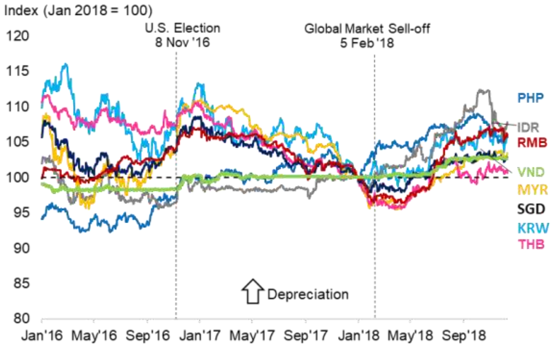
19. Uncertainties and turbulence in global financial markets could lead to increased volatility in capital flows. Vietnam's financial markets experienced some volatility in the later part of last year as a consequence of economic and policy developments in advanced economies, in particular US monetary policy, with the equity market experiencing outflows in July and August and the Vietnamese dong weakening along with regional currencies (Figures 11 and 12).[7] Looking ahead, policy surprises from central banks in advanced economies and unforeseen geopolitical events could lead to renewed turbulence in asset prices and capital outflows from emerging and frontier markets, which may also affect Vietnam.[8]

[6] A substantial portion of Vietnam's exports to the US are manufactured by US multinationals, such as those in the garment industry. Moreover, despite the fact that about 30 percent of Vietnam's exports to the US are loosely classified as machines, these exports are for the most part made by non-Vietnamese multinationals that use Vietnamese labor primarily for assembly, which are unlikely to be targets of US protectionist measures.

[7] Foreign investors' became net buyers of equity again in the fourth quarter.

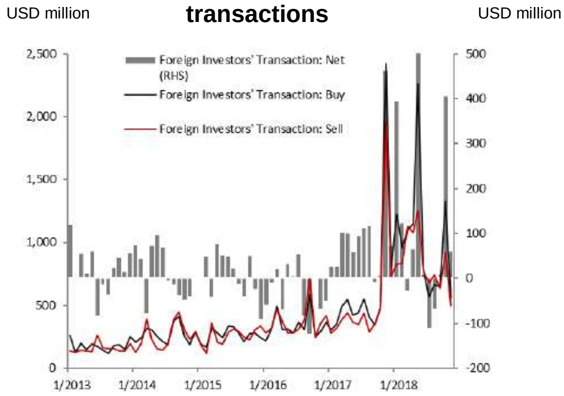
[8] The effect of the Federal Reserve's interest rate hikes on Vietnam would likely be experienced in the form of equity outflows and downward pressure on the exchange rate.

Figure 11. Regional currencies



Source: Thomson Reuters Datastream and AMRO staff calculations

Figure 12. Foreign investors' stock market transactions



Sources: CEIC and AMRO staff calculations

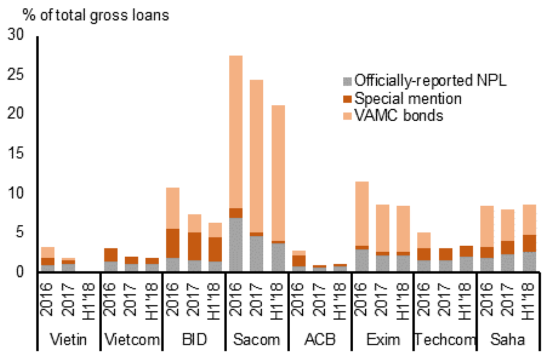
20. Authorities' Views: The authorities generally agreed with AMRO's assessment, noting that the financial account is largely dominated by medium- to long-term flows and therefore relatively stable, although short-term flows have increased due to foreign investors' greater participation in the domestic stock markets. At any rate, fluctuations in the stock markets do not pose a significant risk to external stability, as selling bouts by foreign investors do not readily translate to large capital outflows, with funds remaining onshore and subsequently reinvested in the country. The SBV also mentioned that the exchange rate depreciation experienced in 2018 was under control, at a little over 2 percent compared to the SBV's exchange rate band of ±3 percent.

B.3 Banks' Capital Buffers and NPL Resolution

21. Banking sector risks stem from the relatively low capital buffers and unresolved NPL. Following the enactment of Resolution 42 and Decision 1058/QD-TTgCP, NPL resolution has sped up, with about 35 percent of NPL acquired by the VAMC having been disposed as of end-2018. However, a considerable amount of legacy NPL in the banking system still remains, which weighs on banks' earnings and profitability due to increased provisioning (Figure 13).[9] Meanwhile, banks' capital adequacy ratios (CAR) are projected to decrease as Basel II standards for risk assessment will be applied to all banks by the start of 2020 (Figure 14) (see Annex 1: Financial Sector Development in Vietnam).[10] Going forward, a major correction in real estate prices remains a significant risk to banks which are becoming more exposed to the sector.[11]

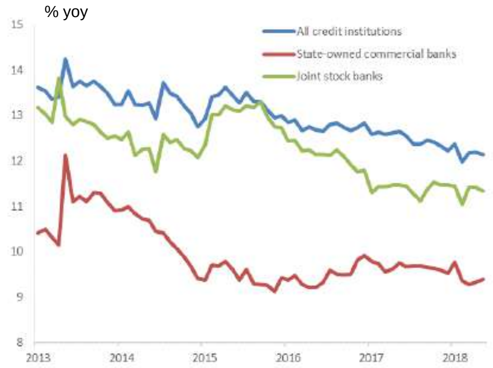
[9] In addition to legacy NPL, banks' capacity in generating income is constrained by banks' heavy reliance on interest income, which accounts for roughly 90 percent of total income, which are generally not as lucrative as fee-based income sources.
[10] Basel II standards, which take into account market risk and operational risk (in addition to only credit risk under Basel I) in risk assessment, will be applied to the entire banking system on January 1, 2020. However, it will be a transitional, Vietnam-specific version of Basel II, with risk weighting less stringent than the official prescription of Basel II.
[11] Mortgage loans have increased robustly in the past few years, which, coupled with loans for other personal consumption purposes (such as car loans) and SME loans, made up about 35.2 percent of total bank loans outstanding as of July 2018, up from 28 percent six years ago.

Figure 13. NPL, Special mention loans, and VAMC bonds



Note: BID stands for Bank for Investment and Development of Vietnam, ACB Asia Commercial Bank, The first three banks are SOCBs and the rest domestic private banks (also known as joint stock banks).
Source: Financial reports of listed banks, and AMRO staff calculations

Figure 14. Capital adequacy ratios



Source: State Bank of Vietnam, IMF, CEIC, and AMRO staff calculations

22. **Authorities' Views:** The authorities highlighted that the banking system's NPL is considered a long-standing legacy issue. The SBV attaches prime importance to NPL resolution, which is reflected in significant progress achieved by some banks and in the moderate amount of remaining legacy NPL in the banking system.

B.4 Fiscal Issues

23. **Increased reliance on non-recurrent revenue sources may undermine the fiscal position in the longer term.** Vietnam's fiscal revenue as a percentage of GDP is relatively high, at about 25.7 percent, and tax and fee revenue accounts for about 21.2 percent. Reflecting reduction in the rate, corporate income tax has declined as a share of GDP in recent years, while VAT and non-tax revenue have increased their shares, offsetting the decline. Although the enhanced VAT collection is commendable, the increased dependence on non-tax revenue, in particular SOE equitization and land-based revenue, may pose a concern for long-term sustainability of revenue sources to meet growing spending needs.[12]

24. **On the expenditure side, one of the key challenges is to improve the provision of public goods and services.** Substantial public resources have been channeled into enhancing infrastructure and business environment, which has facilitated the economic transformation in recent years. However, the infrastructure gap remains large, and the slow improvement in institutional and human resource capacities has constrained more efficient provision of public goods and services.

25. **Authorities' Views:** The authorities noted that proceeds from SOE equitization account for a relatively small proportion of total revenue, on both an annual basis and a

[12] For example, land-based revenue accounted for 2.6 percent of GDP in 2018, compared to 1.4 percent in 2014.

medium-term basis, and thus should not pose a concern on long-term fiscal sustainability.[13] In addition, they emphasized that the goals of SOE equitization are to enhance governance capacity and to create a fundraising channel through the stock market, and that the selection of SOEs to be equitized is on the basis of the quality of the SOEs, not the quantity of potential proceeds. As far as disbursement is concerned, the authorities viewed that Public Investment Law No. 39/2019/QH14, passed by the National Assembly in June this year and effective from 2020, is expected to create conditions for the acceleration of public investment disbursement going forward.[14] The law amends a number of articles to ensure that the projects conform to the nature of capital sources and other relevant laws, such as the State Budget Law.[15]

B.5 Structural Issues

26. Vietnam's rapidly aging population and the slow pace of public sector reforms are some of the key medium to long-term challenges. While Vietnam still benefits from a relatively young population, the low fertility rate and rising life expectancy point to a rapid population aging in the next two decades and the concomitant pressure on the fiscal resources and the sustainability of the expanding social security system (see Annex 3: Assessing Social Insurance Policy Reforms).[16] Another fundamental challenge facing Vietnam is the relative inefficiency of the state-owned enterprises (SOEs), which still commands a significant share of the economy and can at times impede private sector development.[17] Moreover, as Vietnam advances up the value chain, an insufficient supply of skilled labor could become a binding constraint on the transformation of the economy.

27. Authorities' Views: The authorities are of the view that large SOEs have experienced increasing profits and return on equity in recent years, which point to their growing efficiency.

C. Policy Discussion and Recommendations

C.1 Monetary Policy

28. With tighter global financial conditions and strong domestic growth momentum, policy focus should be on maintaining macroeconomic and financial stability. Consequently, the lowering of the credit growth target, from 17 percent in 2018 to 14 percent in 2019 is prudent, especially in light of the relatively high credit-to-GDP ratio. That said, it is essential to maintain sufficient liquidity in the banking system to support lending, especially as

[13] The proceeds are prioritized for projects with high social-economic value.
[14] This law replaces Public Investment Law No. 49/2014/QH13.
[15] For example, regulations on implementation time, medium-term disbursement plans, annual public investment plans, and sector/industry classification need to comply with the State Budget Law.
[16] Due to a host of reasons ranging from the high replacement rate (75 percent) and low retirement age (55 for women and 60 for men) to limited investment opportunities, the social security fund is expected to be depleted by about 2035. As such, the authorities are deliberating a number of initiatives to put the fund on a more sustainable path, including, but not limited to, increasing retirement age and enhancing investment capacity. As far as coverage is concerned, only about 29 percent of the workforce is currently covered by social insurance, because there was no government subsidy for individuals' contributions to the social insurance program until last year.
[17] The SOE sector's investment in the economy accounted for 35.7 percent of total investment in 2017 and 33.6 percent in 2018.

rising lending rates have caused concern among domestic enterprises. Regarding the external position, while a further build-up of the foreign reserves buffer would be beneficial, greater exchange rate flexibility with judicious use of foreign exchange intervention to curb excessive volatility is recommended.

C.2 Macroprudential Policy and Financial Sector Soundness

29. **Enhanced supervision of the banking system and more rapid resolution of the legacy NPL are essential in improving financial sector soundness.** The SBV's continued supervision of lending to certain sectors in the economy, such as real estate and construction, is warranted to mitigate the risk of an asset bubble. The SBV could also consider the use of additional prudential measures such as loan-to-value (LTV) and debt service-to-income (DTI) ratios to complement the existing set of macroprudential tools in reducing potential risks from the rapid growth in mortgage and consumer loans. Recent progress in resolving legacy NPL in several banks is commendable and further efforts to speed up NPL resolution, as well as bank recapitalization, are strongly encouraged to improve the soundness of the banking system.

C.3 Fiscal Policy

30. **With recent encouraging progress in fiscal consolidation, AMRO supports continued efforts and reform initiatives in line with the medium-term fiscal plan.** Continuing efforts to enhance fiscal revenue potential will be critical in the longer term, particularly to fund growing spending needs on development and social security in a sustainable manner. AMRO also recommends greater efforts to improve efficiency in the provision of public goods and services while further prioritizing expenditures to promote long-term growth potential. Policy initiative to shift fiscal deficit financing to greater reliance on domestic and longer-term sources will help reduce vulnerability to currency and maturity mismatch, and will be facilitated by faster development of domestic capital markets.

31. **Authorities' Views:** The authorities viewed that the budget deficit is well-managed in line with the medium-term fiscal consolidation plan. In 2018, state budget collection reached 25.7 percent of GDP thanks to economic growth and state revenue enhancement. Meanwhile, state budget expenditure continued to be managed with thrift and efficiency. As a result, the state budget deficit decreased to 3.46 percent of GDP, lower than the National Assembly's target of 3.7 percent. Looking ahead, the government is likely to keep the budget deficit in 2019 below the target of 3.6 percent of GDP, given relatively satisfactory progress in revenue collection in the first half of the year (52.6 percent of the annual target). Thanks to the government's efforts in strengthening the fiscal position, public debt declined to 58.4 percent of GDP by the end of 2018 and is forecast at around 58 percent by the end of 2019.

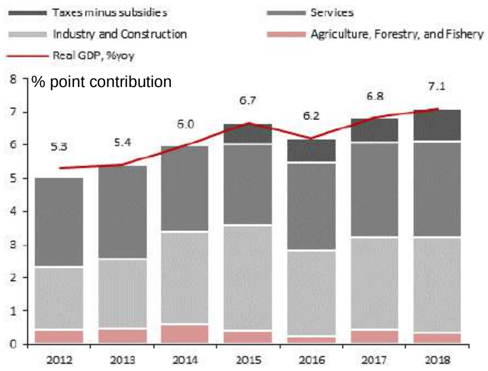
C.4 Structural Policy

32. **Structural reforms should also be accelerated to ensure a sustainable development path.** The creation of the CMSC last September is a commendable step towards improving the governance and performance of major SOEs. With regard to SOE equitization and divestment of state assets, enhanced transparency of the financial positions of the SOEs would be greatly beneficial in expediting the progress. Concerted efforts from relevant state agencies are crucial in addressing fiscal challenges stemming from population aging. The current initiative on recalibrating the parameters of the social security system, such as increasing the legal retirement age, is commendable, and further efforts on reforming the system are essential to ensure its long-term financial sustainability while meeting the needs of the ageing population (see Annex 3: Assessing Social Insurance Policy Reforms). Lastly, improving tertiary education and vocational training are urgently needed upgrade the skillset and quality of the labor force in order to facilitate the country's ascent along the path of economic development.

Appendix 1. Selected Figures for Major Economic Indicators

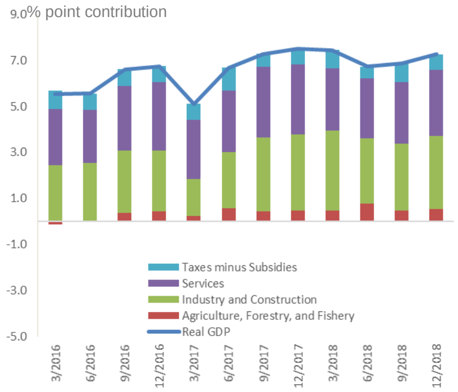
Figure 1.1. Real Sector

Economic growth continued to be robust in 2018…



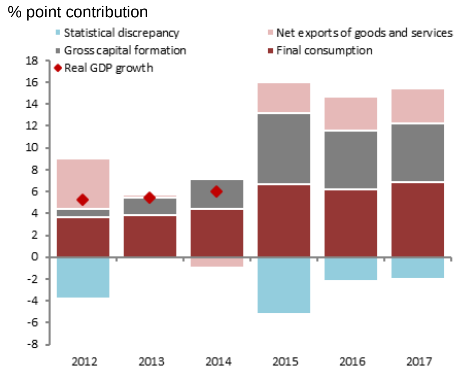
Source: General Statistics Office, CEIC, and AMRO staff calculations

…supported by firm growth in the industry and construction sector.



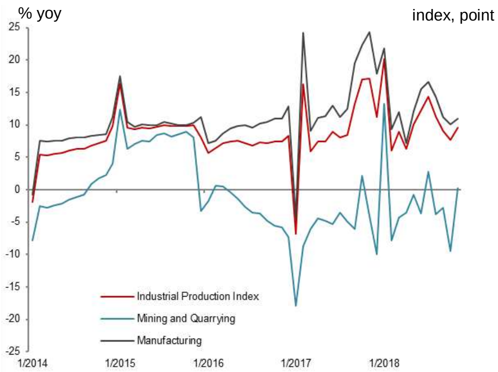
Source: General Statistics Office, CEIC, and AMRO staff calculations

GDP by expenditure indicates steady growth In consumption and net exports over the last few years.



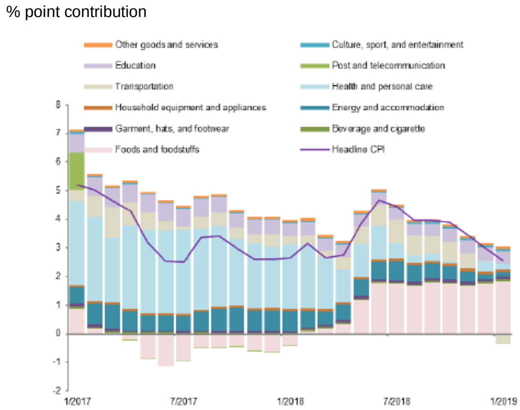
Source: General Statistics Office, CEIC, and AMRO staff calculations

Growth is expected to remain stable in 2019 on the back of continued expansion in manufacturing.



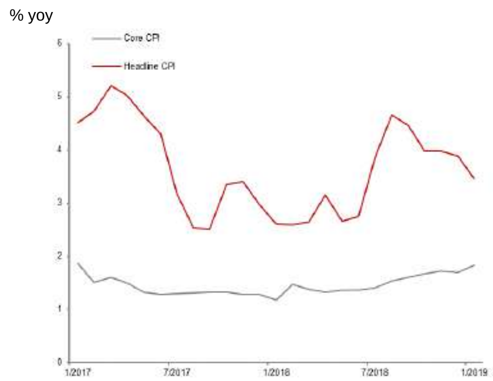
Source: General Statistics Office, CEIC, Nikkei/Markit, and AMRO staff calculations

Headline inflation picked up in the middle of last year as food prices rose…



Source: General Statistics Office, CEIC, and AMRO staff calculations

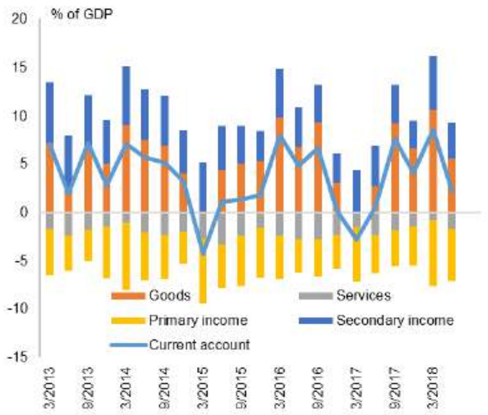
…but core CPI remained subdued.



Source: General Statistics Office, CEIC, and AMRO staff calculations

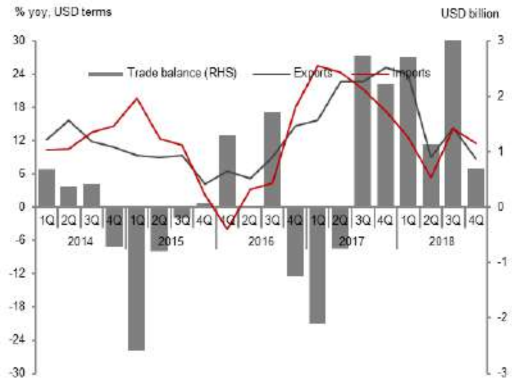
Figure 1.2. External Sector

The current account continued to remain in surplus…



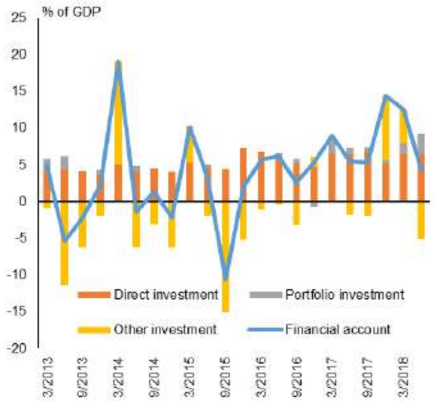
Source: State Bank of Vietnam, CEIC, and AMRO staff estimates

…thanks to the trade surplus.



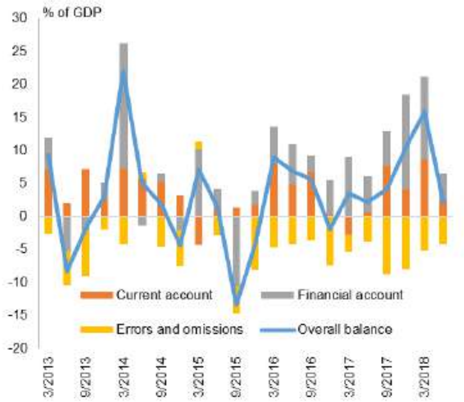
Source: State Bank of Vietnam, CEIC, and AMRO staff estimates

The financial account registered a moderate surplus on the back of foreign investment inflows.



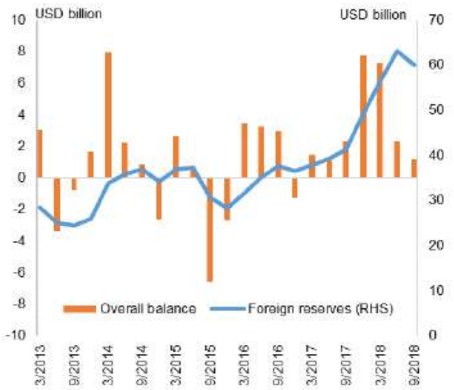
Source: State Bank of Vietnam, CEIC, and AMRO staff estimates

Surpluses in the current account and capital and financial account continued to support the balance of payments…



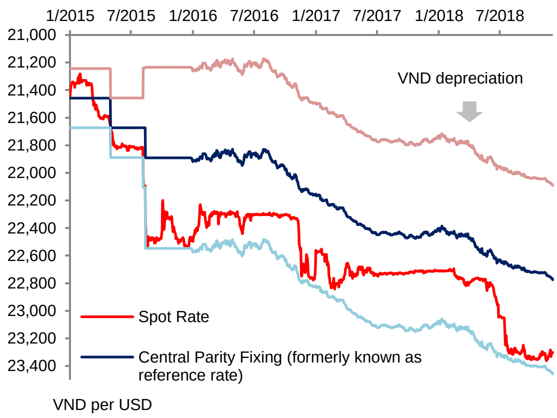
Source: State Bank of Vietnam, CEIC, and AMRO staff estimates

…leading to reserves accumulation...



Source: SBV, CEIC, and AMRO staff estimates

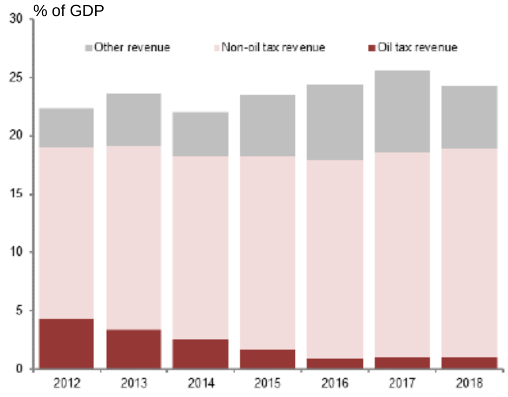
…although the dong depreciated along with other regional currencies relative to the USD.



Source: Thomson Reuters Datastream

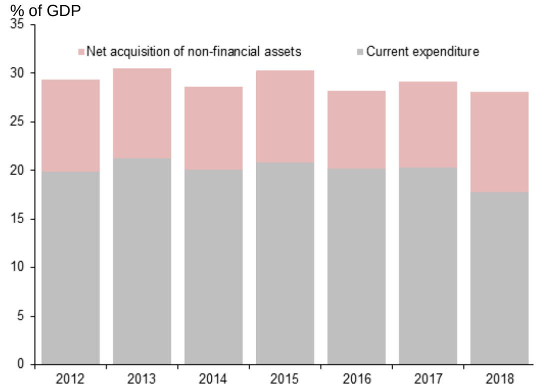
Figure 1.3. Fiscal Sector

Total revenue slowed down on the back of contracting land-based revenue and trade-related revenue…



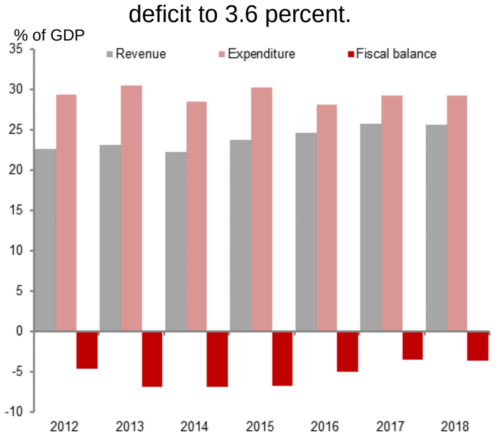
Note: Fiscal data for 2018 based on MOF's November projection..
Source: Ministry of Finance, CEIC, and AMRO staff calculations

…while total expenditure moderated as current spending declined…



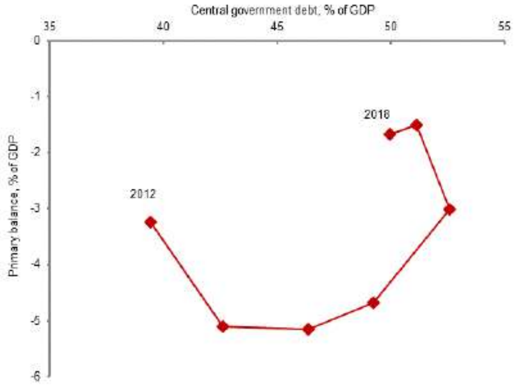
Note: Fiscal data for 2018 based on MOF's November projection...
Source: Ministry of Finance, CEIC, and AMRO staff calculations

…resulting in a slight increase in the overall fiscal deficit to 3.6 percent.



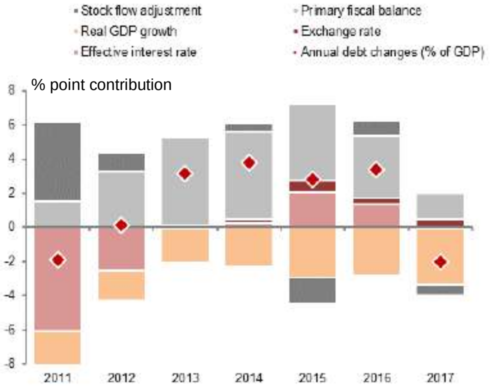
Note: Fiscal data for 2018 based on MOF's November projection..
Source: Ministry of Finance, CEIC, and AMRO staff calculations

Central government debt has been under control…



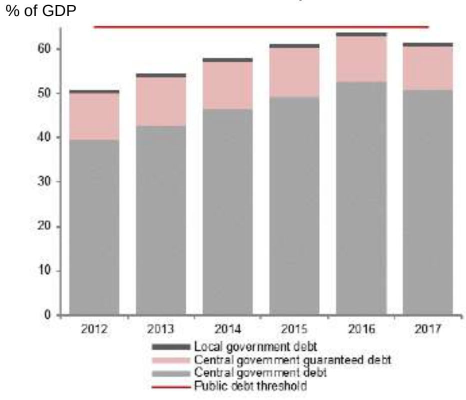
Source: Ministry of Finance, CEIC, and AMRO staff calculations

…with the contraction in primary deficit being the main driver.



Source: Ministry of Finance, CEIC, and AMRO staff calculations

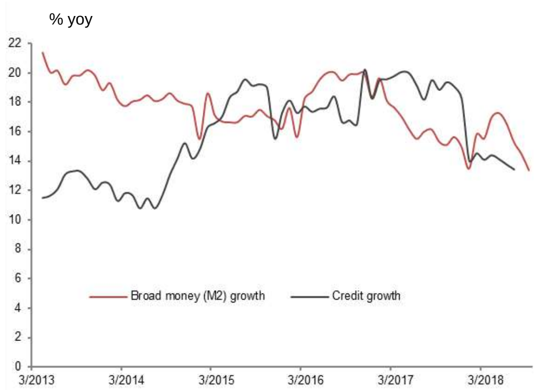
Likewise, public debt declined from 63.6 percent of GDP in 2016 to 61.4 percent in 2017.



Source: Ministry of Finance, CEIC, and AMRO staff calculations

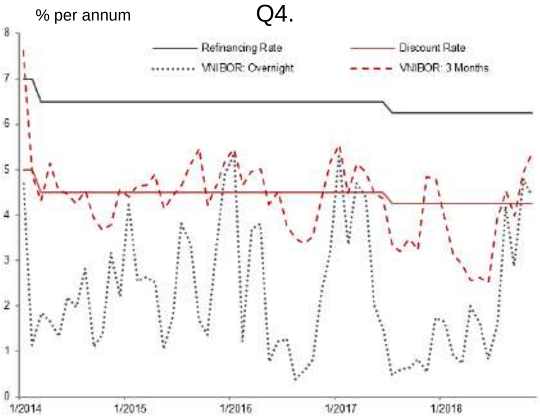
Figure 1.4. Financial Sector

Credit growth moderated last year, in line with SBV's lowering of the credit growth target…



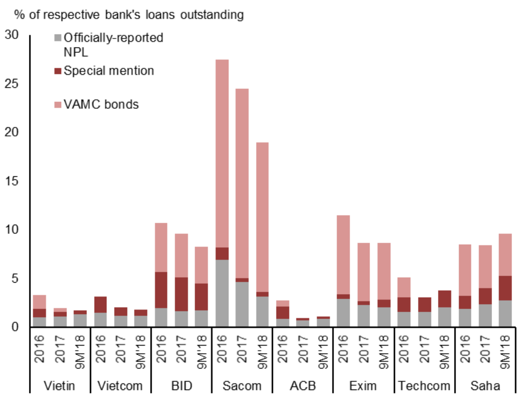
Source: State Bank of Vietnam, IMF, CEIC, and AMRO staff calculations

Monetary conditions remained accommodative, notwithstanding the seasonal liquidity tightness in Q4.



Source: State Bank of Vietnam, IMF, CEIC, and AMRO staff calculations

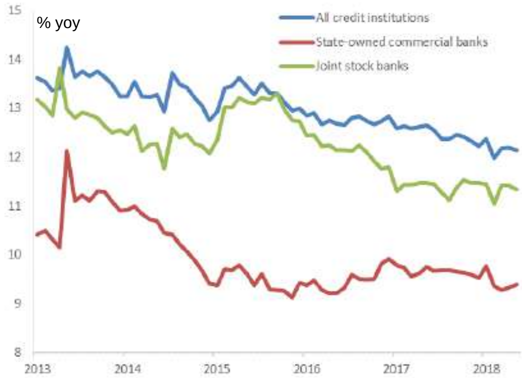
Banks have made some progress in NPL resolution…



Note: BID stands for Bank for Investment and Development of Vietnam, ACB Asia Commercial Bank, The first three banks are SOCBs and the rest domestic private banks (also known as joint stock banks).

Source: Financial reports of listed banks, and AMRO staff calculations

…reflected in declining capital adequacy ratios.

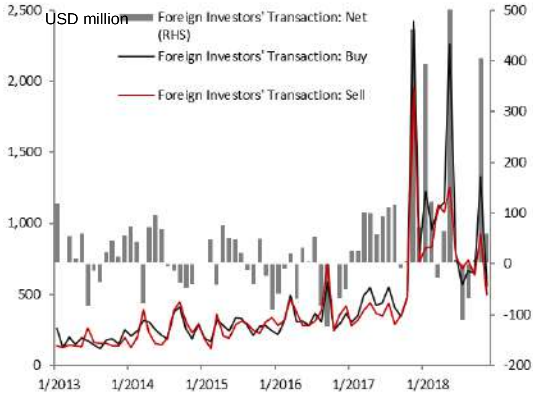


Source: State Bank of Vietnam, IMF, CEIC, and AMRO staff calculations

After a sharp runup in the beginning of last year, domestic stock indices experienced some correction…

Source: HOSE, HNX, CEIC, and AMRO staff calculations

…with negative net foreign investors' purchases in July and August.



Source: CEIC and AMRO staff calculations.

Appendix 2. Selected Economic Indicators for Vietnam

	2015	2016	2017	2018 (est)	Projection	
					2019	2020
National income and prices	(In annual percentage change)					
Real GDP	6.7	6.2	6.8	7.1	6.6	6.7
Consumer price inflation (average)	0.6	2.7	3.5	3.5	3.8	3.7
Balance of payments	(In billions of U.S. dollars, unless otherwise specified)					
Current account balance	0.9	8.2	6.1	10.3	8.3	5.8
In percent of GDP	*0.5*	*4.0*	*2.7*	*4.2*	*3.1*	*2.0*
Trade balance	7.4	14.0	11.5	9.1	8.4	7.6
Service balance	-4.3	-5.4	-3.9	-3.9	-4.3	-4.4
Primary income	-9.9	-8.4	-9.9	-9.5	-9.7	-10.1
Secondary income	7.7	8.0	8.4	8.5	8.7	8.9
Financial and capital account balance	1.6	11.0	20.2	3.6	9.9	15.4
In percent of GDP	*0.8*	*5.4*	*9.0*	1.5	*3.7*	5.3
Direct investment, net	10.7	11.6	13.6	18.0	15.4	16.1
Portfolio investment, net	-0.1	0.2	1.9	1.0	2.4	2.5
Other investment, net	-9.1	-0.9	4.8	-15.4	-7.9	-3.3
Net errors and omissions	-8.5	-10.8	-13.8	-8.1	-8.1	-8.1
Overall balance	-6.0	8.4	12.5	5.8	10.1	13.1
Gross international reserves	28.3	36.5	49.1	54.9	65.0	78.1
In months of imports of goods & services	2.0	2.4	2.7	2.6	2.8	3.0
Coverage of short-term debt by remaining maturity	1.9	2.1	2.6	2.4	2.8	3.2
External debt service/exports of goods and services	3.8	3.3	4.0	3.0	2.8	2.6
Total external debt/GDP	42.0	44.8	48.9	49.0	49.1	49.2
Short-term/total external debt	13.0	13.9	13.0	13.4	13.7	13.8
General government	(In percent of GDP)					
Revenue and grants	23.8	24.5	25.7	25.7	24.0	23.9
Expenditure	28.5	28.7	29.2	29.2	27.6	27.4
Net lending/borrowing balance	-4.7	-4.3	-3.5	-3.5	-3.6	-3.5
Public debt	61.0	63.7	61.4	58.4	57.4	56.9
Monetary sector	(In annual percentage change)					
Claims on the private sector	18.8	18.8	17.4	13.8	14.0	14.0
Broad money	14.9	17.9	14.3	14.0	14.0	13.9
Memorandum items:						
Exchange rate (VND/USD, period average)	21,698	21,932	22,370	22,602.0	23,054	23,515
Nominal GDP (in billions of USD)	193.4	205.3	223.8	244.9	266.9	289.7
Nominal GDP (in trillions of VND)	4,193	4,503	5,008	5,535	6,154	6,812

Note: Direct investment and other investment figures in 2018 reflect the Sabeco transaction.
Sources: National authorities, IMF, World Bank and AMRO staff estimates

Appendix 3. Balance of Payments

	2013	2014	2015	2016	2017
	(in billions of USD, unless otherwise indicated)				
Current account balance (I)	7.7	9.4	0.9	8.2	6.1
Goods	8.7	12.1	7.4	14.0	11.5
Credit	132.0	150.2	162.1	176.6	214.1
Debit	123.3	138.1	154.7	162.6	202.6
Services	-3.1	-3.5	-4.3	-5.4	-3.9
Credit	10.7	11.0	11.2	12.3	13.1
Debit	13.8	14.5	15.5	17.7	17.0
Primary income, net	-7.3	-8.8	-9.9	-8.4	-9.9
Secondary income, net	9.5	9.6	7.7	8.0	8.4
Capital account (II)	0.0	0.0	0.0	0.0	0.0
Financial account (III)	-0.3	5.6	1.6	11.0	20.2
Direct investment, net	6.9	8.1	10.7	11.6	13.6
Inflows	8.9	9.2	11.8	12.6	14.1
Outflows	2.0	1.2	1.1	1.0	0.5
Portfolio investment, net	1.5	0.1	-0.1	0.2	1.9
Inflows	1.4	0.1	-0.1	0.0	1.9
Outflows	-0.1	0.0	0.0	-0.2	0.0
Other investment, net	-8.7	-2.6	-9.1	-0.9	4.8
Inflows	4.2	5.0	5.2	4.3	14.6
Outflows	12.9	7.6	14.2	5.1	9.9
Errors and omissions (IV)	-6.9	-6.6	-8.5	-10.8	-13.8
Overall balance (= I + II + III + IV)	0.6	8.4	-6.0	8.4	12.5
Reserve assets	0.6	8.4	-6.0	8.4	12.5
Memorandum items					
Current account balance (in percent of GDP)	4.5	5.0	0.5	4.0	2.7
Foreign reserves	25.9	34.2	28.3	36.5	49.1
Foreign reserves (months of imports of goods and services)	2.3	2.7	2.0	2.4	2.7
External debt	65.4	72.4	77.8	85.6	104.1
o/w short-term	12.2	13.6	12.0	12.7	21.9
Short-term debt (in percent of foreign reserves)	47.0	39.8	42.4	34.8	44.6
Nominal GDP	171.2	186.2	193.4	205.3	223.8

Source: National authorities, CEIC and AMRO staff calculations

Appendix 4. Statement of Government Operations

	2013	2014	2015	2016	2017
	(in percent of GDP, unless otherwise indicated)				
Revenue (I)	22.9	21.9	23.8	24.5	25.7
Tax	18.2	18.2	18.2	17.9	18.5
Corporate income tax	5.6	5.3	4.8	4.2	4.3
Personal income tax	1.3	1.2	1.4	1.4	1.6
VAT	5.8	6.1	6.2	6.0	6.3
Excise tax	1.5	1.4	1.6	1.9	1.7
Import & export tax	2.2	2.4	2.4	2.1	1.9
Other	1.9	1.8	2.0	2.3	2.7
Fees, charges, and non-tax	3.1	2.4	3.6	4.1	4.5
Capital revenue	1.3	1.1	1.6	2.2	2.5
Grant	0.2	0.2	0.3	0.2	0.2
	0.0	0.0	0.0	0.0	0.0
Expenditure (II)	26.8	25.6	28.5	28.7	29.2
Current expenditure	20.7	20.3	20.9	20.8	20.3
Administration	2.7	2.5	2.6	2.6	2.6
Economic	2.0	1.9	2.0	2.0	2.2
Interest payment	1.3	1.7	2.0	1.9	2.0
Social expenditure	9.9	9.5	9.6	9.3	9.2
Other	4.8	4.7	4.7	5.0	4.4
Capital expenditure	6.1	5.3	5.6	6.0	7.3
	0.0	0.0	0.0	0.0	0.0
Overall balance (= I - II)	-3.9	-3.7	-4.7	-4.3	-3.5
Public debt	54.5	58.0	61.0	63.7	61.4
o/w central government debt	42.6	46.4	49.2	52.7	51.7
External	21.3	20.6	20.7	21.0	20.8
Domestic	21.3	25.8	28.5	31.7	30.9
Memorandum items					
Government-guaranteed debt	11.1	10.7	10.9	10.3	9.1
External	5.3	5.4	5.9	5.7	5.0
Domestic	5.8	5.4	4.9	4.6	4.1
Nominal GDP (in trillions of VND)	3584.3	3937.9	4192.9	4502.7	5007.9

Sources: National authorities, CEIC and AMRO staff calculations

Appendix 5. Monetary and Financial Sector

	2013	2014	2015	2016	2017
Monetary Survey	(in trillions of VND, unless otherwise indicated)				
Foreign Assets: Net	612.7	826.0	836.1	948.5	1264.4
Domestic Credit	3788.0	4353.3	5183.6	6177.3	6930.4
o/w Claims on General Government: Net	406.7	530.1	688.5	731.6	556.1
o/w Claims on Private Sector	3469.7	3949.7	4692.9	5575.1	6546.1
Money	989.3	1199.4	1414.8	1670.9	1950.5
Quasi Money	3383.4	3939.0	4563.5	5412.0	6212.7
Securities Other Than Shares	159.4	96.4	197.0	276.0	373.8
Restricted Deposits	46.7	60.1	51.2	46.4	45.5
Capital Accounts	752.0	745.8	810.1	878.5	992.0
Other Items: Net	-88.4	-126.5	-197.9	-129.4	-171.8
Banks					
Reserves	188.9	201.5	257.8	255.1	359.2
Claims on Monetary Authorities: Securities	51.0	138.7	0.0	8.0	17.4
Foreign Assets	309.6	313.1	423.9	379.6	475.4
Claims on Government	379.2	522.8	605.6	700.5	566.2
Claims on Private Sector	3469.7	3949.7	4692.9	5575.1	6546.1
Demand Deposits	510.5	615.4	729.6	862.4	1004.1
Time and Savings Deposits (local currency)	2834.3	3373.1	3913.5	4791.5	5556.5
Time and Savings Deposits (foreign currency)	530.4	546.6	640.1	617.0	642.2
Memorandum items					
Broad Money (in percent of total reserves)	7.7	6.9	9.4	8.5	7.1
Broad Money (annual growth rate, percent)	21.4	19.7	14.9	17.9	14.3
Broad Money (in percent of GDP)	117.0	127.5	137.6	151.1	155.3
Domestic Credit (in percent of GDP)	108.2	113.8	128.3	140.1	141.9
To Private Sector	96.8	100.3	111.9	123.8	130.7
To Central Government	11.4	13.5	16.4	16.2	11.1

Sources: National authorities, CEIC and AMRO staff calculations

Appendix 6. Data Adequacy for Surveillance Purposes: a Preliminary Assessment

Surveillance Areas	Data Availability[(i)]	Reporting Frequency/ Timeliness[(ii)]	Data Quality[(iii)]	Consistency[(iv)]	Others, if Any[(v)]
National Accounts and Inflation	Yearly GDP data are available for both the expenditure and production approaches. Quarterly GDP data by expenditure, however, have not been made available. Core CPI inflation data have been released since 2015. CPI data have been rebased to 2014 [previous base year: 2009] with a new CPI basket weight system based on 2014 consumption.	Estimated GDP data are released within the final week of each quarter; while revised data are usually released by the end of the following quarter.	High-frequency data, such as industrial production and retail sales indices, are not seasonally adjusted and are sometimes in nominal terms only.	-	-
Balance of Payments and External Position	-	Quarterly balance of payments data have been released at the SBV website with a time lag ranging from one to two quarters.	Persistent net errors and omissions make the analysis and interpretation of the data difficult.	-	-
State Budget and Government/ External Debt	Quarterly state budget data are available. Data on State-owned-enterprise (SOE) debt are seldom available.	The latest Debt Bulletin, which was released in November 2018, reported debt data up to 2017.	Public debt cover central government debt, local government debt, and central government guaranteed debt only. SOE debt is excluded from the public debt statistics.	-	The newly-revised State Budget Law has made the reporting of budget data more in line with international standards, effective January 2017.
Money Supply and Credit Growth	Domestic credit data by currency domination, i.e. LCY and FCY, have yet to be made available.	Monthly data have been released at the SBV website with a time lag of two to four months.	-	-	-
Financial Sector Soundness Indicators	-	Monthly data have been released at the SBV website with a time lag of two to six months.	-	-	Officially-reported NPL data may not capture the full picture of NPL in the banking sector. A reference with NPL acquisition and disposition at the Vietnam Asset Management Corporation is hence useful.
SOE Statistics	SOE statistics have yet to be made available on a frequent basis.	-	-	-	-

Notes: (i) Data availability refers to whether the official data are available for public access by any means, (ii) Reporting frequency refers to the periodicity that the available data are published. Timeliness refers to how up-to-date the published data are relative to the publication date, (iii) Data quality refers to the accuracy and reliability of the available data given the data methodologies, (iv) Consistency refers to both internal consistency within the data series itself and its horizontal consistency with other data series of either same or different categories, and (v) Other criteria might also apply, if relevant. Examples include, but are not limited to, potential areas of improvement for data adequacy.
Source: AMRO Staff Compilation

Annexes: Selected Issues

Annex 1: Financial Sector Development in Vietnam[18]

1. **Vietnam's financial sector consists of a still-dominant banking system and an evolving capital market.** As of 2017, bank claims on the private sector was about 130 percent of GDP; whereas stock market capitalization was about 51.6 percent, and the local currency (LCY) bond outstanding and total asset of the insurance sector were 21.5 percent [19] and 6.3 percent, respectively. [20] The domestic banking system has developed from initially four state-owned commercial banks in the late 1980s into 35 commercial banks[21] by 2017. In addition, there are nine foreign bank subsidiaries, four joint-venture banks, two policy banks, one central people's credit fund, and about 50 foreign bank branches. Non-bank financial institutions include finance and leasing firms, microfinance institutions, credit cooperatives, insurance companies, and pension funds. The capital market took off in the early 2000s with the establishment of the Ho Chi Minh Stock Exchange – HOSE (formerly known as Ho Chi Minh Stock Trading Centre) in 2000, followed by the Ha Noi Stock Exchange – HNX (formerly known as Ha Noi Stock Trading Centre) in 2005 and the launch of an Unlisted Public Company (UpCOM) market and a specialized Government Bond (G-Bond) trading platform at HNX in 2009, and most recently, a derivative market, also at the HNX, in 2017. Table A1.1 shows Vietnam's rapid financial deepening in the past two decades, which has been correlated with greater financial inclusion, reflected in a rising share of the population with bank access in recent years.

Table A1.1. Vietnam's Financial Sector Indicators, 1995-2017

In percent of GDP, unless otherwise indicated	1995	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017
Bank claims on private sector	18.5	35.3	60.5	114.7	101.8	94.8	96.8	100.3	111.9	123.8	130.7
Stock market capitalization[1/]	-	-	-	26.0	15.9	20.9	23.4	24.7	26.8	32.3	51.6
LCY bond outstanding[2/]	-	0.3	5.0	16.0	15.3	16.3	18.6	22.5	22.0	22.2	21.5
Insurance sector assets	0.6	0.9	3.5	4.6	3.8	3.5	3.7	4.4	4.8	5.5	6.3
Bank account ownership, percent of population aged 15+	-	-	-	-	21.4	-	-	30.9	-	-	30.8
Bank deposit accounts per 1,000 adults	-	-	-	253	505	618	678	781	854	963	-

Note: [1/] Stock market capitalization consists of HOSE and HNX only. If the UpCOM market is also included, the total market capitalization is up to about 70 percent of GDP, as of end-2017. [2/] Data are sourced from the Asian Development Bank (ADB)'s Asian Bonds Online database, which likely exclude the amount of about VND324 trillion worth of loans held by Vietnam Social Security (VSS) prior to 2016 and subsequently converted into government bonds – which is equivalent to about 7 percent of GDP. If those historical borrowings from VSS are included, total LCY bond outstanding has been higher than 27 percent of GDP since 2016, according to local media quoting Ministry of Finance of Vietnam's reports.
Sources: National Authorities, CEIC, ADB's Asian Bonds Online Database, and AMRO Staff Calculations

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[18] Prepared by Nguyen Thi Kim Cuc

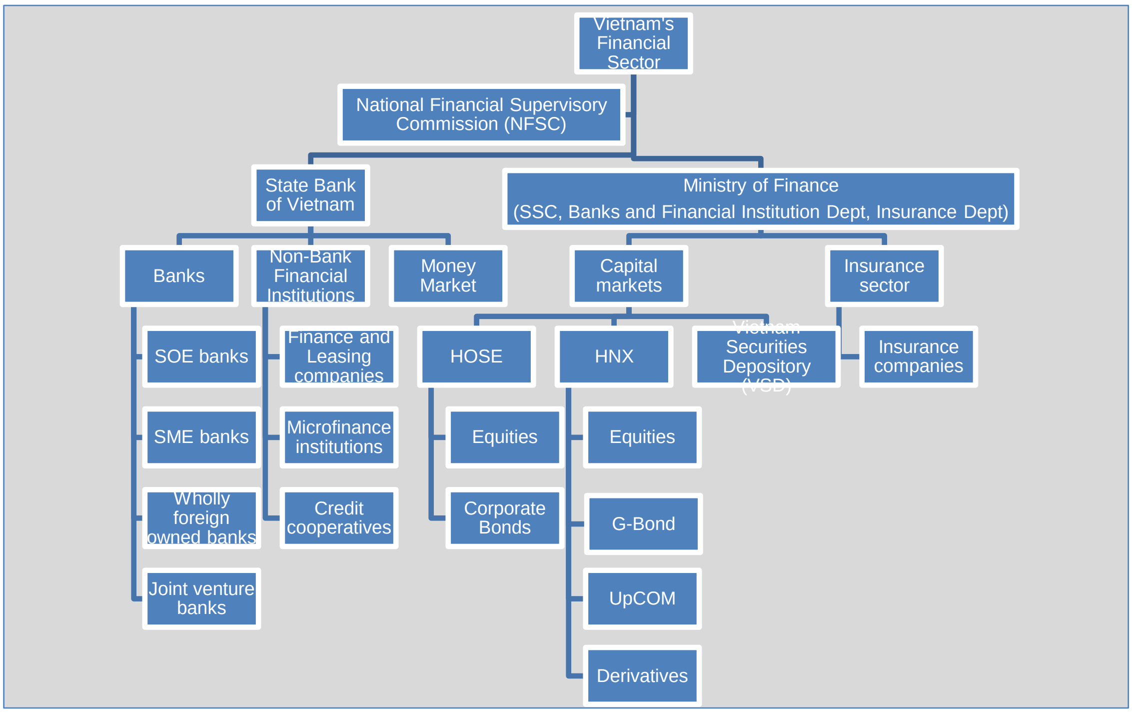
[19] Data are sourced from the Asian Development Bank (ADB)'s Asian Bonds Online database, which likely exclude the amount of about VND324 trillion worth of loans held by Vietnam Social Security (VSS) prior to 2016 and subsequently converted into government bonds – which is equivalent to about 7 percent of GDP. If those historical borrowings from VSS are included, total LCY bond outstanding has been higher than 27 percent of GDP since 2016, according to local media quoting Ministry of Finance of Vietnam's reports.

[20] According to the Prime Minister's Decision 450 dated 2012 to approve the Fiscal/Financial Sector Development Strategy until 2020, it has been targeted that the stock capitalization value would reach 50 percent of GDP by 2015 and about 70 percent by 2020, LCY bond outstanding at about 30 percent of GDP by 2020, and insurance revenue at about 2-3 percent of GDP by 2015 and 3-4 percent of GDP by 2020.

[21] In terms of ownership, four out of those 35 banks are 100-percent State-owned (Agribank, and the three banks acquired by SBV in 2015 at zero cost), three are majority-owned by the State (Vietcombank, Vietinbank, and BIDV), and the rest are private banks. The seven SOE banks account for about 40 percent of total bank assets and the private banks (SME banks) account for another 40 percent of total assets, and the remaining assets are accounted by wholly foreign owned bank subsidiaries.

2. **Financial regulatory and supervisory authority is shared mainly between the State Bank of Vietnam and Ministry of Finance.** Banks and non-bank financial institutions, such as credit cooperatives, finance and leasing firms, microfinance institutions, as well as the money market, are under the State Bank of Vietnam (SBV)'s regulation and supervision. The Ministry of Finance, meanwhile, is in charge of regulating and supervising the insurance industry and the capital market. As far as the capital market is concerned, the State Security Commission (SSC) and the Banks and Financial Institution Department under Ministry of Finance are responsible for regulating and supervising the stock and bond markets, respectively. The National Financial Supervisory Commission (NFSC) was established in 2008 in an effort to centralize the authority of financial supervision into one single agency; however, to date, the NFSC has yet to assume such authority, leaving the supervision of the financial institutions still shared between the SBV and MOF (Figure A1.1).

Figure A1.1. Vietnam's Financial Sector Structure



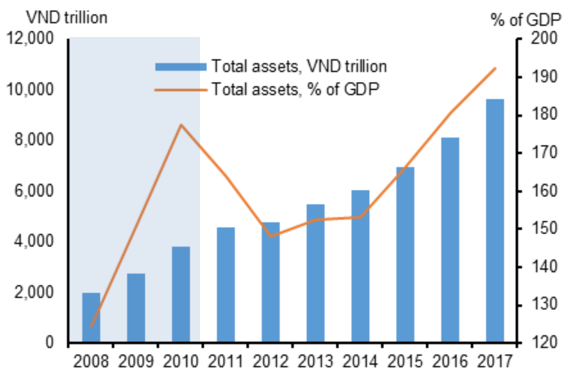
Sources: National Authorities and AMRO Staff Compilations

3. **A rapid expansion of the banking sector preceding the establishment of a complete regulatory and supervisory framework, coupled with expansionary macroeconomic policies to promote growth, led to excessive credit growth, high inflation and asset bubbles between 2005-2010.** The number of domestic banks ballooned from 28 in 2005 to about 44 by 2010, driven by a wave of converting "rural" banks or credit cooperatives into fully licensed commercial banks, leading to their assets doubling in size during the same period (Figure A1.2). This had preceded the enforcement of prudential regulations[22] and a new Law on Credit Institutions in 2010. In response to

[22] The key document issued by the State Bank of Vietnam in 2010 to regulate banks' prudential ratios is Circular 13, which was later amended by Circular 19 (also in 2010). Circular 13 came up with a set of specific regulatory ratios for minimum capital adequacy, credit thresholds/quotas, as well as capital contribution and shareholding, and loan to deposit ratio, among others. For instance, banks were required to maintain their capital at a minimal of 9 percent of their (credit) risk-weighted assets (compared to 8 percent stipulated in the 1997 Credit Institutions Law). Lending limits to one single borrower and/or group of related borrowers were also specified, such as loans outstanding held by one single borrower and one group of related borrowers could be up to 15 percent and 25 percent of bank's own capital, respectively. The loan to deposit ratio was capped at 80 percent for commercial banks, and 85 percent for non-bank financial institutions.

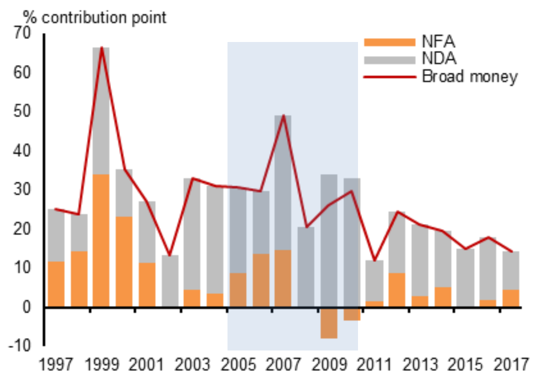
strong capital inflows, emanating from easy monetary conditions globally and investors' optimism following Vietnam's WTO membership in 2007[23], the SBV conducted forex interventions to accumulate foreign reserves and issued SBV bills and adjusted the reserve requirement ratio to sterilize the liquidity but did not do so sufficiently, in part contributing to robust liquidity growth (Figure A1.3). Most significantly, loose monetary conditions were maintained throughout the period, except for a brief tightening in 2008, which, coupled with a large fiscal stimulus package in 2009, sustained rapid credit growth until early 2011. Under a lax regulatory and supervisory environment, bank loans found their way to sectors with high credit risks, in particular securities investment and real estate, fueling asset bubbles in these markets, and pushing inflation to two-digit levels (Figure A1.4).

Figure A1.2. Total Bank Assets



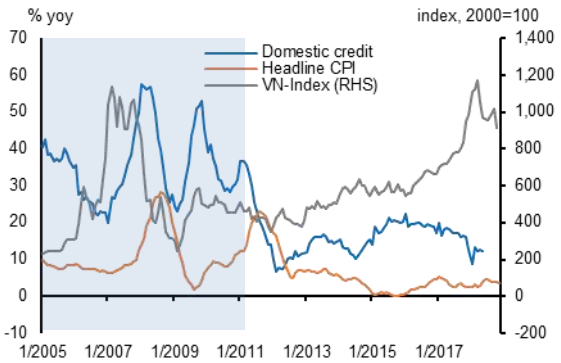
Sources: National Authorities, CEIC, and AMRO Staff Calculations

Figure A1.3. Contribution to Broad Money Growth



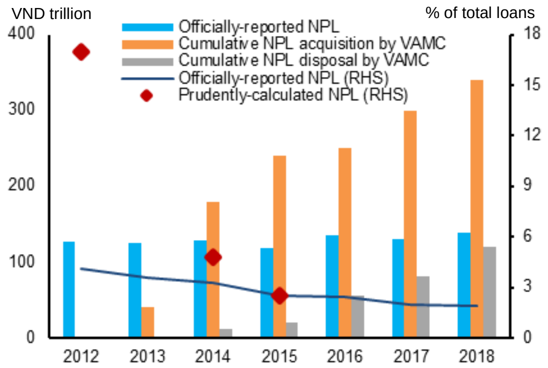
Sources: National Authorities, CEIC, and AMRO Staff Calculations

Figure A1.4. Credit, Inflation, and VN-Index



Sources: National Authorities, CEIC, and AMRO Staff Calculations

Figure A1.5. Non-Performing Loans



Note: Data for 2018 are estimates.
Sources: National Authorities, CEIC, and AMRO Staff Calculations

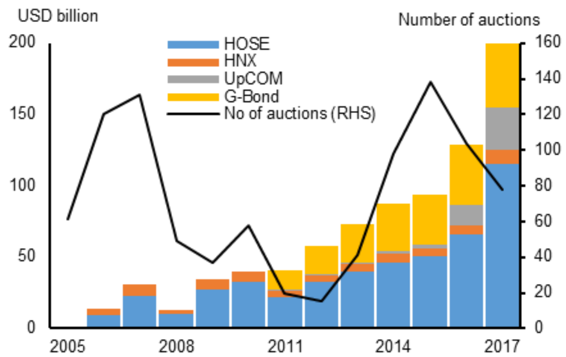
4. **Banks have since focused on resolving the non-performing loans which increased sharply in 2011-2012.** The SBV tightened monetary policy in 2011 to curb inflation and restore macroeconomic stability. The steep rise in interest rates had led to a credit crunch and a sharp rise in Non-Performing Loans (NPL) among banks, which stood at 17 percent of total loans outstanding, as at end-2012 (Figure A1.5). NPL resolution measures were implemented, including the establishment of the Vietnam Asset Management Corporation (VAMC) in 2013 to purchase the NPLs from banks in exchange for non-interest bearing 5-year bonds[24], and most recently, a pilot NPL resolution scheme endorsed in Resolution 42 in 2017. In recent years, several banks have repurchased their NPLs from

[23] Net capital inflows however quickly reversed to net outflows on investors' risk aversion amid the Global Financial Crisis (GFC) and rising inflation domestically.
[24] Some of which have been extended up to 10 years.

the VAMC and written them off[25], and NPL disposal at the VAMC has also picked up pace[26]. Bank consolidation has reduced the number of domestic banks from the peak of 44 in 2010 to about 35, as at 2017. Bank prudential regulations have continued to be refined and strengthened, with the target for full implementation of Basel II standards set at the start of 2020.

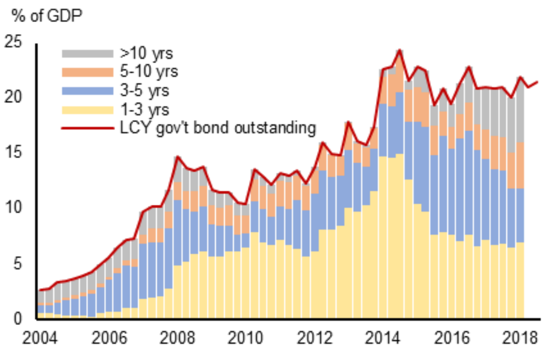
5. **The recent growth in the stock market is associated with rising market capitalization, partly driven by an SOE equitization push and foreign ownership limit relaxation.** Increased SOE equitization and divestment auctions[27], coupled with a mandatory registration at the UpCOM market[28], have increased total market capitalization to about USD155 billion in 2017 (Figure A1.6). From the demand side, regulatory changes, most notably Decree 60 in 2015 that removed in principle the 49-percent foreign ownership limit among listed firms, have facilitated greater foreign participation – which accounts for about one third of total stock trading in recent years (Table A1.2). Foreign investors have continued to purchase Vietnamese equities since 2017, while some outflows were observed in July-August 2018 when emerging and frontiers markets were hit by investors' risk aversion amid rising global uncertainties.

Figure A1.6. Market Capitalization and Number of Auctions in the Stock Market



Sources: National Authorities, CEIC, and AMRO Staff Calculations

Figure A1.7. LCY Government Bond Outstanding Composition by Remaining Maturity



Sources: National Authorities, CEIC, and AMRO Staff Calculations

6. **The government bond market have also increased in size, in tandem with a broadened investors' base and increased liquidity in both the primary and secondary markets.** With the recent participation of Vietnam Social Security (VSS) in bond auctions in the primary market, long-term investors, including VSS, insurance companies and the State-owned investment arm, State Capital and Investment Corporation or SCIC, now hold up to nearly half of total government bonds outstanding, from less than 20 percent in 2011[29]. Bonds with tenors up to 20 years and 30 years have been issued to meet the demand of such long-term investors, which helped lengthen the average

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[25] As of end-2018, about 8 commercial banks completed buying back their NPLs transferred to the VAMC earlier and wrote them off from their own books, including Vietcombank, Vietinbank, Asia Commercial Bank, Military Bank, and Techcombank, among others.
[26] As of end-2017, cumulative NPLs disposed of by the VAMC was about VND81 trillion, or about 27 percent of cumulative NPLs acquired by the VAMC since 2013 (of VND300 trillion). This amount is estimated to increase to VND120 trillion, or about 35 percent of cumulative NPLs acquired by the VAMC (of VND340 trillion), as of end-2018.
[27] Examples of large-scale SOEs that went through equitization and divestment during this period include Vietnam Airlines, Vinamilk, and Saigon Beer Company (Sabeco). A number of legal documents that sought to accelerate the process were the Prime Minister's Decision 929 in 2012 approving SOE restructuring plan for 2011-15, the Governmental Resolution 15 in 2014 on accelerating SOE equitization, the Prime Minister Decision 58 in 2016 on SOE classification and re-arrangement for 2016-20, and the Prime Minister's Decision 1232 in 2017 on SOE equitization plan for 2017-2020.
[28] The UpCOM was launched at Ha Hoi Stock Exchange in 2009, in a bid to provide a centralized trading platform for over-the-counter (OTC) transactions, which would help the authorities to collect information and regulate this market,
[29] Commercial banks' holding of government bonds meanwhile declined from about 80 percent of total outstanding in 2011 to less than 50 percent in 2018. On a contrary to the stock market, the presence of foreign investors in the government bond market has been modest and trended downward to only 1-2 percent of total outstanding in recent years.

bond maturity (Figures A1.7). Trading of government bonds in the secondary market has also increased in volume, following the launch of the G-Bond platform at HNX in 2009, and the issuance of Governmental Decree 01 in 2011 to improve the legal framework for the government bond market.

7. **Going forward, challenges remain in sustaining the financial deepening momentum while improving banking sector soundness and further developing the capital market as an source of raising medium to long-term funding.** In the banking sector, despite the recent progress in NPL legacy resolution, about VND220 trillion worth of special VAMC bonds, equivalent to about 3 percent of total loans outstanding, are still held by banks, as of end-2018. As banks have shifted to retail lending in recent years[30], bank regulation and supervision should be further strengthened, and macroprudential measures, such as Loan-to-Value (LTV) caps, could be considered. In light of increased participation of foreign investors, the stock market has become more vulnerable to the risk of capital flow volatility going forward. From a market development perspective, the co-existence of fragmented platforms with different listing products and requirements may hinder the overall efficiency and transparency of the stock market. In particular, a majority of equitized SOEs have registered with the UpCOM of sub-standard requirements and lower liquidity, without a binding timeline for being formally listed. In the government bond market, the current investor base could be further diversified with the emergence of private pension funds in the future. Coordination among relevant authorities regulating the money and bond markets could be further strengthened, in particular with sharing and exchange of information related to open market operations, while a benchmark government bond yield curve has yet to be established. Last but not least, the corporate bond market remains modest, with total outstanding at 1.4 percent of GDP, as at 2017, underpinned by the corporate sector's still-heavy reliance on bank loans and the lack of necessary infrastructure and institutions, such as domestic credit rating agencies, to support market development.

Table A1.2. Stock and Bond Market Indicators, 2000-2018

In percent	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017	2018
Stock market capitalization to GDP	-	-	26.0	15.9	20.9	23.4	24.7	26.8	32.3	51.6	-
Stocks trade to GDP	-	-	16.5	5.5	-	6.1	11.7	9.7	10.8	17.0	-
Turnover ratio (total shares traded/capitalization)	-	-	63.6	34.7	-	26.0	47.3	36.0	33.5	33.0	-
Foreign investors' transactions, in percent of all trading transactions		21.6	21.2	35.5	30.8	32.0	25.1	28.2	30.5	27.6	34.8
Total LCY bond outstanding to GDP	0.3	5.0	16.0	15.3	16.3	18.6	22.5	22.0	22.2	21.5	-
o/w, government bonds	0.3	5.0	12.1	12.3	14.9	17.4	21.6	20.9	20.9*	20.0*	-
o/w, corporate bonds	-	-	3.9	2.9	1.5	1.1	0.9	1.2	1.3	1.4	-
Ratio of private to total debt securities	13.8	0.8	24.1	19.2	8.9	6.0	3.9	5.2	5.9	6.6	-
Stock market capitalization plus outstanding domestic private debt securities to GDP	-	-	29.8	18.8	22.4	24.5	25.6	28.0	33.7	53.0	-

Note: */ Government bond outstanding data in the table are sourced from ADB's Asian Bonds Online website. According to MOF's reports, LCY government bond outstanding was above 27 percent of GDP since 2016. It is likely that the authorities' number includes the amount of about VND324 trillion worth of loans held by VSS prior to 2016 and subsequently converted into government bonds – which is equivalent to about 7 percent of GDP.
Sources: National Authorities, ADB's Asian Bonds Online Database, CEIC, and AMRO Staff Calculations

[30] SBV's (aggregate) loans outstanding (by sector) data dated back to 2012 show that the share of bank loans to the "others" category – which are mainly retail lending, including mortgage loans and loans for other personal consumption purposes (car loans, for instance), as well as SME loans, among others – in total loans outstanding, increased from 28 percent as of end-2012 to about 35 percent as of end-2017.

Annex 2: Assessing the Vulnerability of Public Debt in Vietnam[31]

1. **A standard debt sustainability analysis (DSA) framework is used to assess Vietnam's public debt over the medium term.** Robust GDP growth in 2018, and a tightened fiscal policy strictly in line with a five-year medium-term fiscal consolidation plan, would helped contain public debt growth and reduce debt levels. Under baseline assumptions that primary deficit is contained below 2 percent (around 1.8 percent on average for the next five years) and average GDP growth rate is at around 6.7 percent per annum, Vietnam's public debt-to-GDP is forecast to gradually fall from 58.4 percent of GDP in 2018 to 54.6 percent in 2023. The decline in the public debt-to-GDP ratio will contribute towards a larger fiscal space and help in increasing confidence in Vietnam's macroeconomic sustainability going forward.

2. Table A2.1. Baseline Debt Scenarios Assumption and Projected Public Debt Indicators, 2018-2023

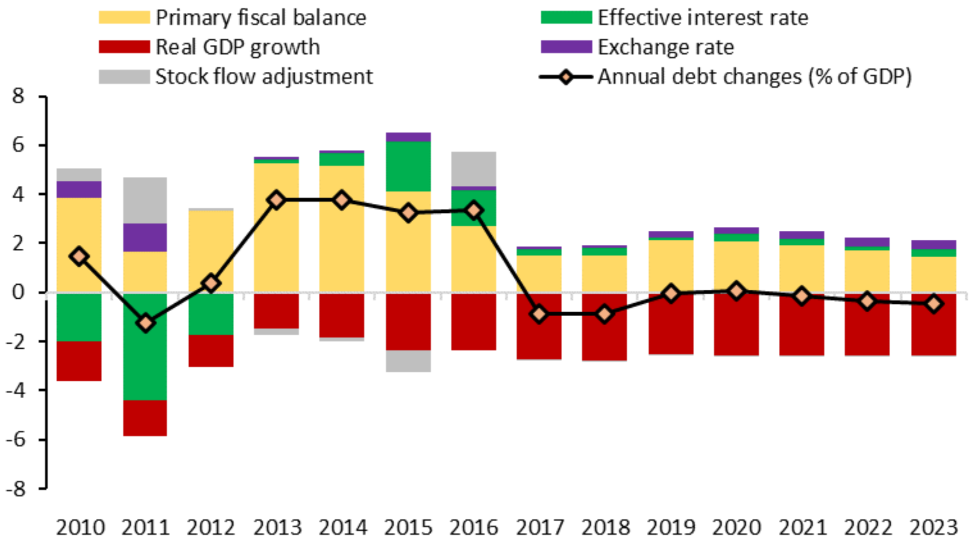
(percent)	2018	2019	2020	2021	2022	2023
Baseline debt scenarios assumption						
Real GDP growth (%, yoy)	7.1%	6.6%	6.7%	6.7%	6.7%	6.7%
GDP deflator	3.3%	4.3%	3.8%	3.7%	3.6%	3.3%
Primary deficit	1.7%	2.1%	2.1%	1.9%	1.7%	1.5%
Fiscal deficit	3.5%	4.0%	3.9%	3.7%	3.4%	3.1%
Nominal exchange rate depreciation	0.8%	2.0%	2.0%	2.0%	2.0%	2.0%
Interest rate	4.4%	4.8%	4.8%	4.5%	4.4%	4.3%
Projected public debt indicators						
Public debt	58.4%	57.4%	56.9%	56.3%	55.5%	54.6%
Government debt/GDP	50.0%	49.7%	49.5%	49.2%	48.7%	48.0%
Direct Gov. debt service/ revenue	15.9%	21.3%	22.8%	23.9%	19.8%	18.7%

Source: National Authorities; AMRO staff estimates

2. **Decomposing the drivers behind the debt dynamics, the steady decline in the public debt-to-GDP ratio is primarily due to Vietnam's fast and sustained GDP growth rate and a firm decline in the fiscal deficit.** The effect from real GDP growth is partially offset by the primary deficit (gradually decreases from 2.1 to 1.5 percent of GDP) – the largest contributor in the upward direction – lesser extent, exchange rate depreciation and effective interest rate. Exchange rate depreciation contributes relatively less to debt-flow creation when compared to other contributors as the government has been increasingly relying on domestic financing in its medium-term debt management strategy (the share of foreign currency debt to total public debt is expected to be contained at around or below 40 percent until 2023).

[31] Prepared by Nguyen Manh Duc

Figure A2.1. Public Debt Level Declines Due to Strong GDP Growth, Efforts to Contain Fiscal Deficit



Source: National Authorities; CEIC; AMRO staff calculations

3. To assess the vulnerability of public debt, the following three shock scenarios are considered.

a. **Growth shock**: In this shock scenario, the GDP growth rate is assumed to decrease by one standard deviation of real GDP growth rates over the past 10 years. In particular, we assume a decline from the baseline growth average of 6.7 percent to an average of 6.1 percent for the period from 2019 to 2023.

b. **Primary balance shock**: In this scenario, we assume a sharp increase in the primary deficit-to-GDP ratio in 2019 and 2020 by one standard deviation of the 10-year historical primary deficit to GDP ratios. In particular, we assume an increase of 0.8 percent in primary deficit to GDP ratio in 2019 and 2020 (from 2.1 percent in baseline scenario to around 2.9 percent in shock scenario accordingly).

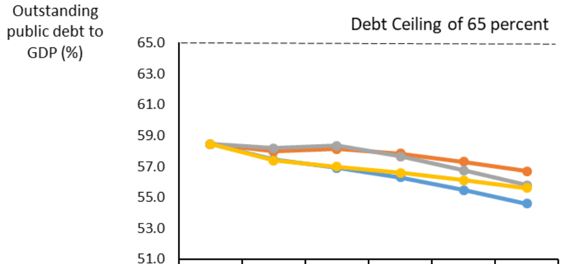
c. **Interest rate and foreign exchange rate shocks (combined shock):** We assume the increase in interest rates by 200bps and depreciation of the nominal exchange rate by 9 percent in 2019 compared to the baseline scenario. Subsequently, the deterioration in exchange rates could result in rising prices of imported oil and gas, putting pressure on inflation to rise accordingly (estimation from 4 percent to 6.6 percent in shock scenario).

4. **Vietnam's public debt is most vulnerable to a primary balance shock and growth shock.** A simulation shows the ratio of public debt to GDP increases to peak at 58.3 and 58.1 percent under primary balance shock and growth shock respectively, while the combination shock on interest rate and exchange rate has a much lesser impact on the public debt ratio in the medium term. (Figure A2.2) Under all three shock scenarios, Vietnam's public debt remains below the threshold of 65 percent mandated by the National Assembly.

5. **The government debt service-to-fiscal revenue ratio is most vulnerable to the combination of a foreign and interest rate shock.** Under all scenarios, the ratio of government debt service to fiscal revenue – an indicator to assess the government's capacity in fulfilling its debt obligation – gradually increases and peaks in 2020-2021 due to a large proportion of domestic

government bonds coming due (Figure A2.3). While combination shocks of the interest rate and FX rate could mostly exacerbate the debt burden (measures in debt to GDP ratio) over the medium term, the debt service-to-revenue ratio remains below the threshold of 25 percent mandated by the National Assembly.

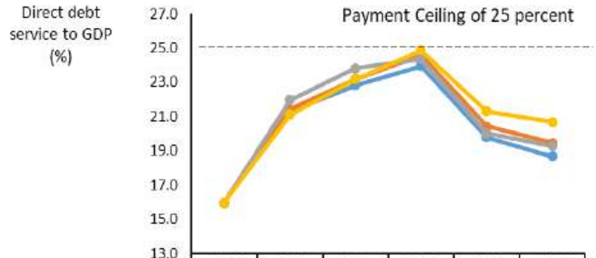
Figure A2.2. Outstanding Public Debt to GDP



	2018	2019	2020	2021	2022	2023
Baseline	58.4	57.4	56.9	56.3	55.5	54.6
Growth shock	58.4	58.0	58.1	57.8	57.3	56.7
Primary shock	58.4	58.2	58.3	57.6	56.7	55.8
IR and FX shock	58.4	57.4	57.0	56.6	56.1	55.6

Source: National Authorities; CEIC; AMRO staff calculations

Figure A2.3. Direct Government Debt Service to Revenue



	2018	2019	2020	2021	2022	2023
Baseline	15.9	21.3	22.8	23.9	19.8	18.7
Growth shock	15.9	21.4	23.2	24.6	20.4	19.5
Primary shock	15.9	22.0	23.8	24.3	20.0	19.3
IR and FX shock	15.9	21.1	23.2	24.9	21.3	20.7

Source: National Authorities; CEIC; AMRO staff calculations

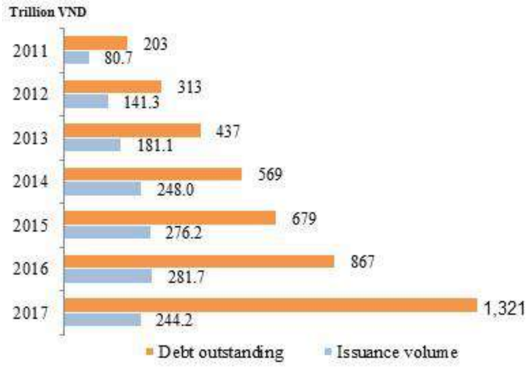
6. **Since 2015, there has been a shift towards longer duration bonds, which should help the government manage its debt service profile.** According to Decree No. 25/2016/QH14 on the five-year fiscal plan for the period of 2016-2020, the share of not less than 5-year tenor bonds must account for at least 70 percent of total bond issuance. As a result, the share of 5-year bond issuances increased sharply in 2015, accounting for approximately 50 percent of total bond issuance compared to an average of 25 percent in the 2011-2014 period.[32]

7. **Government bond yields witnessed a downward trend, contributing to a lower government debt services burden.** Following an episode of macroeconomic volatility in 2008, which led to a spike in yields between 2010 and 2011, government bond yields have trended downwards to nearly a decade low, reflecting an economy witnessing robust growth, improved liquidity and higher investor confidence (weighted average interest rates in 2011 and 2017 stood at 12 percent and 5.98 percent respectively) (Figure A2.5).

8. **Although public debt levels are still relatively high, the debt profile and, to some extent, the steady development of a domestic capital market, tend to effectively contain its vulnerability to macroeconomic shocks**. Previous access to highly concessional long-term financing contributed to lower borrowing costs (the effective interest rate was at around 1.5 percent at the end of 2017) and longer average time-to-maturity (ATM) (around 10-12 years at the end of 2017). In the area of domestic debt, Vietnam has taken strategic measures to deepen the local debt capital market, which in turn has contributed to lengthening tenure of domestic debt portfolios ATM (around 6.7 years at the end of 2017), effectively addressing refinancing or rollover risks.

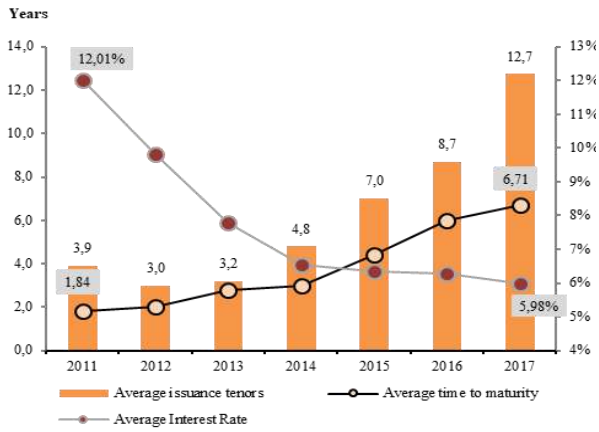
[32] In 2017 and 2018, bonds moved towards even longer durations (10- to 15-year tenors). In 2018, 10-30-year tenor bond issuance accounted for more than 88 percent of total bond issuance.

Figure A2.4. Government Bond Market and Volume of Government Bond Issuance



Source: National Authorities; CEIC; AMRO staff calculations

Figure A2.5. Average Issuance Tenors and Interest Rate

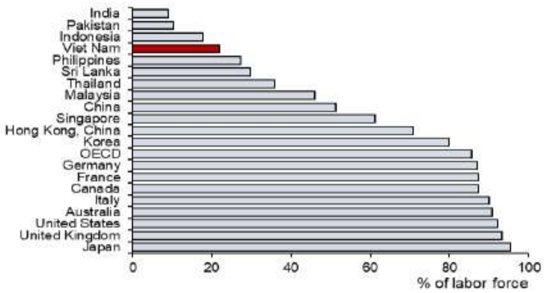


Source: National Authorities; CEIC; AMRO staff calculations

Annex 3: Assessing Social Insurance Reforms[33]

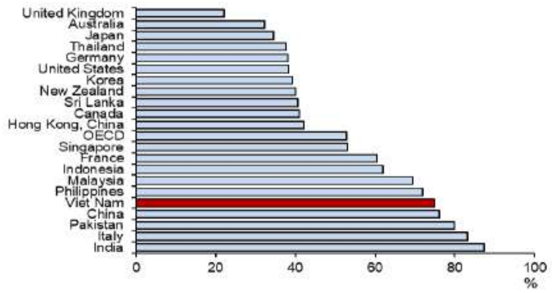
1. **Vietnam's social pension system, known locally as social insurance (SI)[34], has been characterized by a low coverage among the workforce as well as imbalances between low contributions and generous benefits.** A latest OECD pension survey shows that Vietnam's mandatory pension coverage remains very low, compared to not only those of advanced economies but of most ASEAN-5 (Figure A3.1). In contrast, its pension benefit, at 75 percent of lifetime average earnings for average earners, is relatively high among the countries under survey (Figure A3.2).

Figure A3.1. Coverage of Mandatory Pension Scheme



Note: As of 2016.
Source: OECD (Pensions at a Glance Asia/Pacific 2018); World Bank Pension Database; National Reports

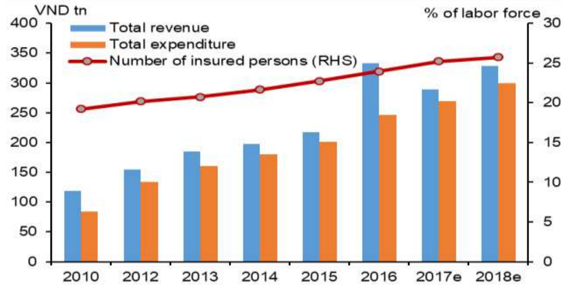
Figure A3.2. Gross Pension Replacement Rates



Note: Defined as pension benefit as a share of individual lifetime average earnings for average earners.
Source: OECD Pension Models

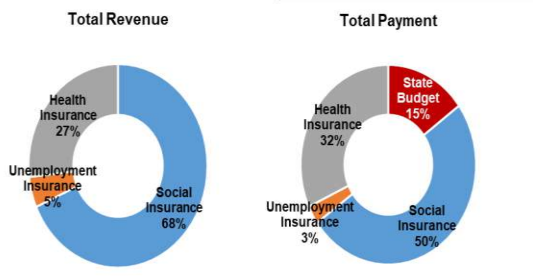
2. **Vietnam's SI program has been expanding recently.** The share of labor force participating in SI has gradually increased in recent years up to about 26 percent in 2018, mainly driven by the government's policy initiatives. Accordingly, SI revenue and payment also showed a gradual increase, while total revenue continued to exceed total expenditure (Figure A3.3) given relatively low coverage and still young demographic structure. As of November 2018, the SI revenue accounted for about two-thirds of the total social security revenue. Meanwhile, one half of total social security expenditure was financed by the SI fund. It is worth noting that the State Budget also contributed to financing as large as 15 percent of the total expenditure (Figure A3.4).

Figure A3.3. Social Insurance Revenue and Payment



Source: Vietnam Social Security (VSS)

Figure A3.4. Social Security Revenue and Payment Composition in 2018



Note: Based on 11-month performances in January-November 2018.
Source: Vietnam Social Security (VSS)

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[33] Prepared by Jinho Choi

[34] Vietnam's social security system consists of three key pillars – (i) social insurance (mainly, old-age pension), (ii) health insurance, and (iii) social assistance. In this *Annex*, social insurance (SI) is defined as per the GSO's Statistical Yearbook, i.e., social insurance is a guarantee to replace or partly compensate employee' income when his/her income is reduced or lost due to sickness, maternity, occupational accident, occupational disease, outside of the labor force or death on the basis of their contribution to the social insurance fund. Due to the old-age pension's dominant share in social insurance, we use the terms social insurance and old-age pension interchangeably here.

3. **The authorities have made further commitments to expanding the SI coverage.** In May 2018, the government announced that the overall SI policy as a main pillar of the social security system will be reformed to promote social progress and equality (Resolution. No. 28-NQ/TW). As overall objectives, it aims to gradually expand the coverage of social insurance to develop flexible, diversified, multi-layered, modern and international SI system; improve the capacity, effectiveness and efficiency of state's social insurance management; and develop the system of implementing SI policies in a streamlined, professional, modern, effective, trustworthy, and transparent fashion. As specific goals on SI, 60 percent of labor force is targeted to participate in SI and 60 percent of retirees can receive pension benefits by 2030 (Table A3.1).

Table A3.1. Detail Goals of Social Insurance Policy

Time to Achieve the Targets	Share of Labor Force Participating in SI	Share of Farmers & Informal Sector Participating in Voluntary SI	Share of Labor Force Participating in Unemployment Insurance	Share of Retirees Receiving Pension Benefits
Period to 2021	35%	1.0%	28%	45%
Period to 2025	45%	2.5%	35%	55%
Period to 2030	60%	5.0%	45%	60%

Source: The Central Committee of the Communist Party of Vietnam (Resolution No.28-NQ/TW, May 23, 2018)

4. **We conduct a simple simulation exercise to assess potential impacts of alternative policy reform scenarios on the SI sustainability.** In this exercise, we aim to make a comparison of potential impacts on SI net revenue under counterfactual SI reform policies with regard to the coverage of mandatory pension scheme, a reduction in per-person pension benefits, and extension of retirement age. The SI net revenue at year t (NR_t) can be obtained as the difference between total SI revenue (TR_t) and expenditure (TE_t).[35] To this end, we decompose the SI net revenue data into the unit price and quantity terms; that is, each insurer's SI contributions ($contr_t$) and the number of insurers ($nins_t$) to make a long-term projection using the historical data available from 2010 to 2016. By the same token, total SI expenditure can be factored into each pensioner's SI benefit (ben_t) and the number of pensioners ($npen_t$). Namely,

$$NR_t = TR_t - TE_t$$

$$= nins_t * contr_t - npen_t * ben_t$$

The scope of our simulation is up to 2049 to reflect Vietnam's long-term demographic changes according to the Vietnam authorities' latest projection in 2016. We set our baseline scenario as the case where the coverage of SI will maintain the recent gradual trend increase of 1.1 percentage point each year. Key assumptions are summarized as follows:

[35] Ideally, we need to assess the long-term sustainability of the Vietnam's Social Insurance Fund, comprising not only accumulated net revenues, but also interim fund flows as well as reinvestment earnings. Due to lack of the latter information available, here we take the net SI revenue as main object of analysis.

- SI Revenue: The number of SI insurers ($nins_t$) increases at the pace of the past five year's (2014-18) trend. The unit amount of SI contribution per insurer ($contr_t$) rises in proportion to changes in the GDP deflator.[36]

- SI Expenditure: The number of pensioners ($npen_t$) increases in tandem with the number of SI insurers, or old-age dependency ratio. The unit amount of SI benefit per pensioner (ben_t) is also adjusted to changes in the GDP deflator, which will widen the gap between average SI benefit and contribution per person because the former will start to grow from a currently three-times higher level than the latter.[37]

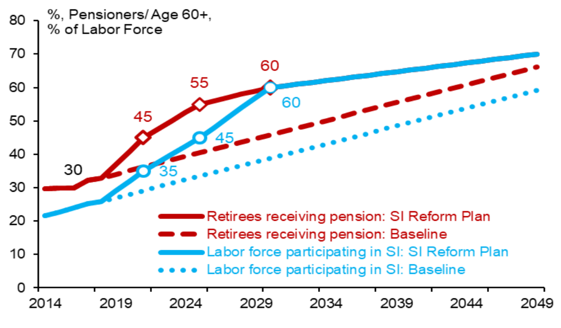
5. SI reform scenarios. Against the baseline, we take into account three scenarios with the one reflecting the latest SI reform target to expand the coverage up to 60 percent of labor force by 2030 and with the other two augmenting lower benefits and later retirement options. Alternative scenarios are summarized as follows:

- Scenario 1: The SI coverage ($nins_t$) increases up to 60 percent of labor workforce by 2030 as targeted in the reform plan. The number of pensioners ($npen_t$) also is expanded as intended in the reform plan (i.e., 60 percent by 2030). For the period beyond 2030, it is assumed that both ratios will gradually converge to 70 percent by 2049 (Figure A3.5). Under the reform plan, the ratio of pension receivers to contributors begins to stay lower than the baseline after 2025 onward (Figure A3.6)

- Scenario 2: Scenario 1 + The unit amount of SI benefit per pensioner (ben_t) is reduced by 0.5 percent per year (as illustration) from 2019 onward.

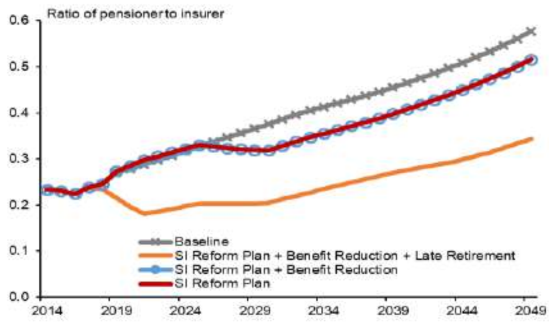
- Scenario 3: Scenario 2 + Retirement age is postponed to age 65 (as illustration) from 2019 onward.

Figure A3.5. The Coverage of Social Insurance in Labor Force by Scenario



Note: The SI Reform Plan is based on (Resolution No.28-NQ/TW, May 23, 2018) along with some staff assumptions beyond 2049.
Source: Government Statistical Office; AMRO staff calculations

Figure A3.6. Pension Receiver-to-Contributor Ratio by Scenario



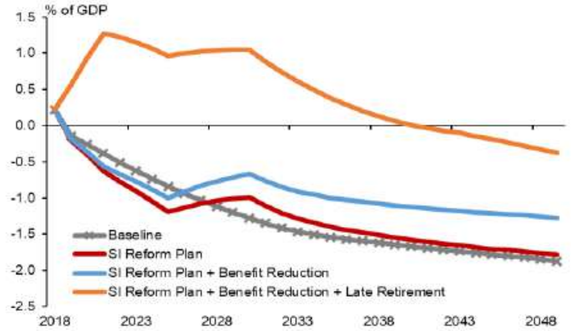
Note: The SI Reform Plan is based on (Resolution No.28-NQ/TW, May 23, 2018) along with some staff assumptions beyond 2049.
Source: Government Statistical Office; AMRO staff calculations

[36] We assume that the near-term inflation rates for GDP deflator range from 3.3 percent to 4.3 percent while converging to 2 percent by 2049. Furthermore, labor force participation ratio is fixed at 76 percent during the projection period.
[37] According to the staff calculation, as of 2016, the average SI contribution per person remains at VND18.8 million, only one-third of the average per-person benefit (VND57.2 million).

6. Our simulation results show that a combination of pension reforms and the extension of retirement age helps to enhance the sustainability of the SI policy.

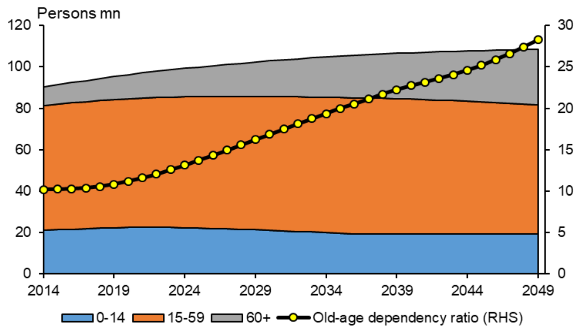
- Under the baseline scenario, the annual SI net revenue is expected to show a deficit from 2019 onward. Even with a mild increase in the SI coverage, the size of deficits will likely to widen to 2 percent of GDP by 2049 (Figure A3.7), mainly led by a combination of widening the gap between the unit SI contribution and benefit and rapid population aging from the long-term perspective (Figure A3.8).
- Under the SI Reform Plan (Scenario 1) with more aggressive expansion of the coverage, net SI revenue will deteriorate in the near-term at a steeper pace than the baseline, followed by a mild improvement in deficits owing to the increase in gross pension contributions. However, the size of SI net revenue is projected to converge to that in the baseline case eventually.
- To highlight the need to push forward further SI reforms, we considered additional policy adjustments such as pension benefit reduction – by 0.5 percent annually (Scenario 2) – as well as immediately delaying retirement age to 65 from 60 on top of the benefit cuts (Scenario 4). Our simulation results show that restructuring pension contribution and benefits will improve the deficits in net SI revenue to some extent. Furthermore, extending legal retirement age is expected to make a substantial improvement in the SI balance by delaying the time before net SI revenue turns into a deficit, especially when combined with other policy reform measures.

Figure A3.7. Projected Social Insurance Net Revenue by Policy Scenario



Note: In the experiments, pension benefit reduction assumes 0.5 percent's annual decrease, while imposing a late retirement at age 65 from 2019 onward.
Source: Government Statistical Office; AMRO staff calculations

Figure A3.8. Vietnam's Aging Population



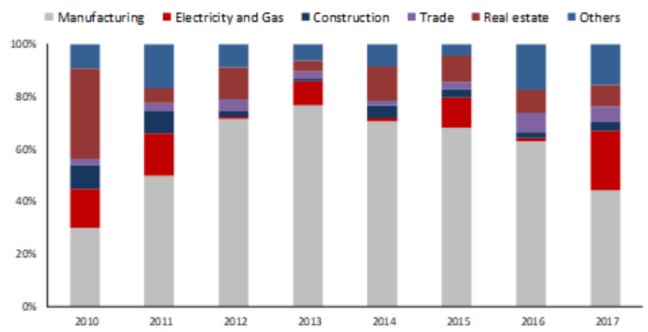
Note: Based on the authorities' official projections made in 2016.
Source: Government Statistical Office; AMRO staff calculations

7. More concrete SI financing plans must be established to enhance long-term sustainability of the SI fund, especially as Vietnam is entering into rapid population aging. If successfully implemented, the authorities' ongoing SI reform plan is expected to contribute to promoting social welfare and equality. Although expanding the coverage of informal sector workers is a commendable step towards inclusive growth, such a rapid pace of the SI coverage expansion needs more concrete financing considerations, especially given the fact that about 15 percent of total social security payment is currently being financed by the State Budget. Moreover, Vietnam's aging population structure in the coming years implies that the total number of SI beneficiaries will more than double under the proposed scheme. In this regard, regularly recalibrating key parameters of pension benefits and contributions are essential. Furthermore, avoiding early retirement while encouraging capable elderly people to continue to work will be also helpful to cope with rapid population aging.

Annex 4: Evolution of Vietnam's export structure and the impact of global shocks on Vietnam's exports[38]

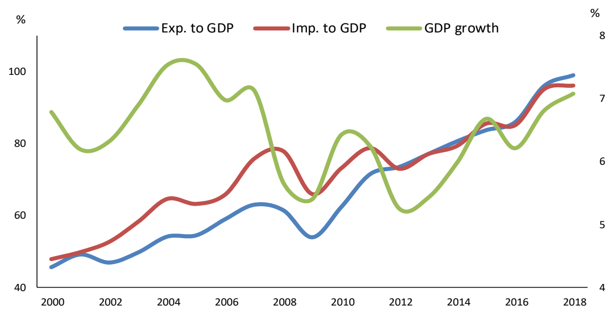
1. **Abundant FDI inflows into export-oriented sectors have transformed Vietnam into a manufacturing powerhouse and boosted the country's potential growth.** After joining the WTO in 2007, Vietnam starting receiving substantial foreign capital inflows, most notably exemplified by Samsung, which entered the country in 2008 with its investment in the electronics sector (Figure A4.1).[39] Exports have continuously contributed to economic growth, which averages at 6.4 percent since 2000. During the same period, exports as a share of GDP increased from 45.5 percent to 99.1 percent (Figure A4.2).

Figure A4.1. Registered FDI by industry



Source: CEIC and AMRO staff calculations

Figure A4.2. Shares of exports and imports in GDP



Source: CEIC and AMRO staff calculations

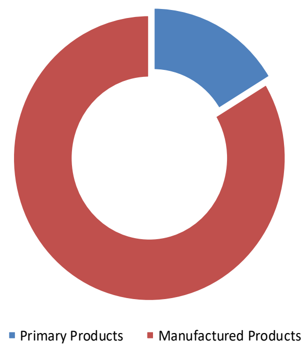
2. **In terms of composition, Vietnam is exporting more manufactured products, particularly electrical products and mobile phones, while oil and agricultural exports have contracted in relatively terms.** With more FDI injected into manufacturing sector, the share of manufactured products in total exports[40], climbed to 84 percent from 55 percent ten years ago (Figure A4.3). Exports of electrical products and parts, and telephone, mobile phone, and parts accounted for one third of total exports in 2018, increasing from a mere 4 percent in 2008 (Figure A4.4). Meanwhile, exports of textile, garment, and footwear remained roughly constant at around one fifth of total exports. In contrast, exports of crude oil, fishery products, and other agricultural products such as rice, rubber, and coffee shrank from about 40 percent of total exports in 2008 to only 12 percent in 2018.

[38] Prepared by Sophak Duong and Jade Vichyanond

[39] Foreign sector exports have overtaken domestic sector exports over the last ten years, increasing from 43 percent of total exports in 2006 to 70 percent in 2018, and are expected to increase further as Vietnam remains an attractive destination for FDI.

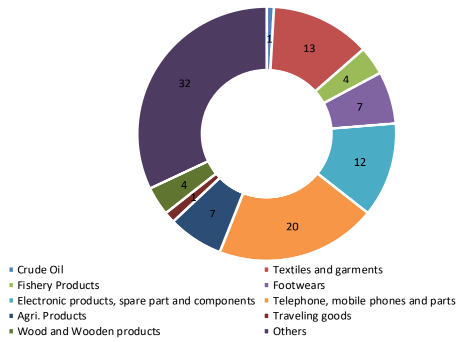
[40] According to the Standard International Trade Classification (SITC)

Figure A4.3. Exports by major product group, 2018



Source: CEIC and AMRO staff calculations

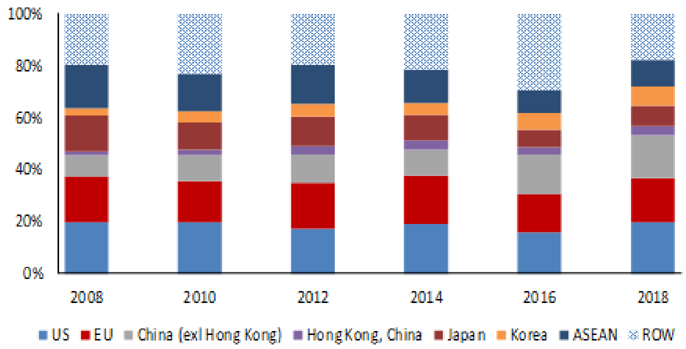
Figure A4.4. Exports by product, 2018



Source: CEIC and AMRO staff calculations

3. **China is increasingly becoming an important market for Vietnam exports. Exports to** China has expanded more rapidly than to any other markets in the region. China's market share doubled to 17 percent in 2018 from 8 percent in 2008 (Figure A4.5). Meanwhile, the US' market share remained roughly constant at 20 percent of Vietnam's total exports, as has the EU's share, which stood at 17 percent.

Figure A4.5. Exports destinations, 2008



Source: CEIC and AMRO staff calculations

4. **Vietnam's exports to China consist more of primary goods than Vietnam's exports to the US.** Vietnam's exports of primary goods accounted for 27 percent of total merchandise exports to China, with crude oil, fishery, mining and other agricultural products among major primary goods exported to China (Figure A4.6). Meanwhile, primary goods account for only 10 percent of Vietnam's exports to the U.S., dominated by crustaceans and other agricultural items such as fruits, nuts, coffee, and peppers (Figure A4.7). As for manufactured goods, textile and garment and electronic components and products are constitute the lion's share of manufactured goods exports to both China and the US.

Figure A4.6. Exports to China, 2018

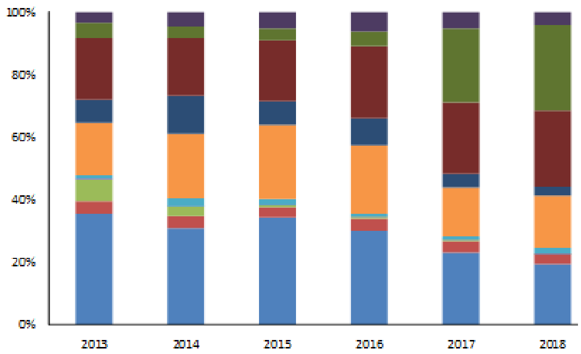
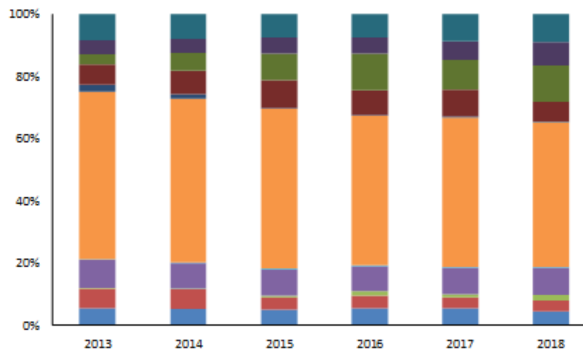


Figure A4.7. Export to the US, 2018

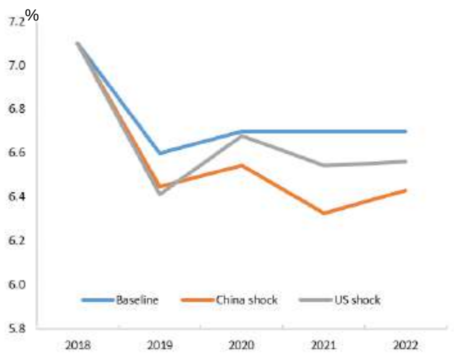


Source: CEIC and AMRO staff calculations

5. **To quantify the impact of such a slowdown on Vietnam's macroeconomic indicators, we use Oxford Economics' Global Economic Model.**[41] We examine the impact of shocks to the US' and China's GDP growth on Vietnam's economy. Our assumption is a 1-percentage point decrease in the GDP growth of the US (China), from the model's baseline projections, during the period of Q4 2018 to Q4 2021. The variables of interest are the trajectories of Vietnam's GDP and export growth.

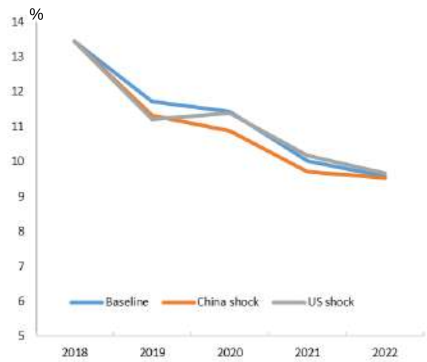
6. **The impact of a China shock on Vietnam's GDP is by and large greater than that of a US shock.** According to the model's estimates, a 1-percentage point drop in China's GDP growth leads to a decline of 0.15 percentage point in Vietnam's GDP growth in 2019, 0.16 percentage point in 2020, and 0.37 percentage point in 2021 (Figure A4.8). Meanwhile, a similar shock to the US' GDP growth is associated with decline of 0.19 percentage point in Vietnam's GDP growth in 2019, 0.02 percentage point in 2020, and 0.16 percentage point in 2021.

Figure A4.8. GDP growth



Source: Oxford Economics and AMRO staff calculations

Figure A4.9. Export growth



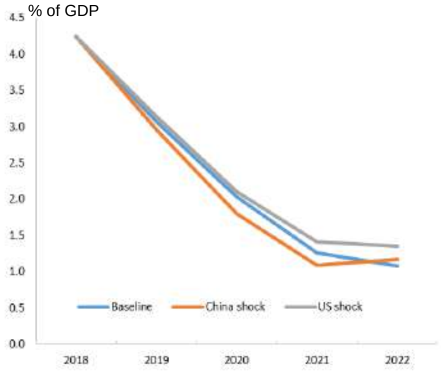
Source: Oxford Economics and AMRO staff calculations

[41] The model is an error correction model, a type of a multiple time-series model that estimates how dependent variables evolve after shocks to independent variables. Used by international institutions, ministries of finance, and central banks in many countries, the model covers 80 economies and is suitable for analyzing linkages among key macroeconomic variables of different economies.

7. **The difference in the GDP growth trajectories is largely driven by a lower export growth path under the China shock scenario.** According to the model's estimates, a 1-percentage point drop in China's GDP growth leads to a decline of 0.4 percentage point in Vietnam's export growth in 2019, 0.5 percentage point in 2020, and 0.3 percentage point in 2021 (Figure A4.9). Meanwhile, a similar shock to the US' GDP growth is associated with a decrease of 0.5 percentage point in Vietnam's export growth in 2019, no change in 2020, and an increase of 0.2 percentage point in 2021. This counterintuitive result (higher export growth than under the baseline scenario) is partially due to the overshooting of world trade growth in the aftermath of the (endogenous) US interest rate cuts in response to a negative output growth shock.[42]

8. **The divergent paths for the current account balance under the two scenarios can in turn attributed to export growth paths and the nature of Vietnam's exports to China and the US.** While the current account balance as a percentage of GDP deteriorates after the China growth shock scenario, the opposite is the case after the US growth shock (Figure A4.10). While this is in part due to the different trajectories of export growth under the two scenarios, it can also be ascribed to the product mix of Vietnam's exports to the two countries. Since primary products, which require relatively little imported intermediate input compared to manufactured products, constitute a greater share of Vietnam's exports to China than of Vietnam's exports to the US, China's growth shock has a more negative impact on the current account balance. In fact, Vietnam's value added for the textile and garment sector and the electronics sector—key engines of the country's export growth—is not substantial in view of these sectors' export shares: exports of textiles, garment, and footwear heavily rely on imports of raw material, while a dearth of local companies capable of producing quality components forces electronics manufacturers to use imported components for the most part.[43]

Figure A4.10. Current account



Source: Oxford Economics and AMRO staff calculations

[42] In particular, world trade is forecast to grow by 4.10 percent in 2021 under the US shock scenario, compared to 4.07 percent under the baseline. In addition, Vietnam's real effective exchange rate is weaker under the US shock scenario than under the baseline, providing additional support for exports.
[43] According to the OECD's I-O Table (2018 edition), import content of Vietnam's exports was 46.3 percent for textiles, wearing apparel, leather and related products and 62.5 percent for computer, electronic, and optical products, as of 2015.

Annex 5: Monetary Policy Instruments in Vietnam[44]

1. **According to the Law on the State Bank of Vietnam (SBV), Vietnam's monetary policy framework encompasses key policy decisions to maintain currency value stability (inflation rate), and tools and measures to achieve them.** Both the National Assembly and the Government have responsibilities in the area of monetary policy. The Government submits the inflation rate target in line with other macroeconomic targets, and implements policies to achieve them upon the National Assembly's approval of the targets. The National Assembly approves the annual target inflation rate and supervises the implementation of monetary policy. As a ministerial agency of the Government, the SBV is responsible for the conduct of monetary policy and has to report the results to the National Assembly at the meetings of the National Assembly's Standing Committee. Besides the target of stabilizing the Vietnam dong (VND), the SBV is also required to ensure adequate levels of liquidity in the financial institutions and the economy, stabilize the money market and foreign exchange market, and support economic growth at an appropriate level. Therefore, the SBV uses a wide range of monetary instruments in a proactive and flexible manner in the implementation of monetary policy. Based on each specific period, the relative importance of each instrument varies.

1. Open Market Operations (OMO)

   OMOs was officially launched in July 2000 and has been carried out in the form of purchases and sales of government bonds. OMO instruments are used to directly influence liquidity in the system, contributing to market stability, supporting the implementation of monetary policy's targets.

   SBV's short-term (7-day maturity) purchase of papers is conducted on a daily basis, using either volume auction or price auction; the chosen mode of auction depends on monetary policy's targets in each period. The OMO bidding rate is based on market conditions and monetary policy objectives. When there is high demand for liquidity due to seasonal factors such as the Lunar New Year, the bidding maturity is extended to longer maturities to ease the liquidity pressure.

   SBV bills with different maturities (14 to 182 days) are used flexibly to control liquidity in the system,[45] to sterilize the purchase of foreign currency for reserve accumulation, or to stabilize the exchange rate when under pressure.

2. Refinancing

   Refinancing is mainly used as a means to provide short-term liquidity support to credit institutions, especially to meet the high level of deposit withdrawals during Lunar New Year. Since 2013, this tool also has been used to support some government programs, such as VAMC's special bonds to provide credit institutions with working capital; housing financial supports for specific group of people such as low income people, cadres, civil servants, public employees and armed forces; refinancing the Bank for

[44] Prepared by Le Phuong Thao

[45] At times, market rates were kept low with excess liquidity to support the issuance of government bonds at a lower cost.

Investment and Development of Vietnam (BIDV) to lend for the anti-flooding project in Ho Chi Minh city. Credit institutions can use commercial papers and credit documents as collaterals for refinancing. By law, refinancing instruments include (a) granting ;loans secured by the pledge of commercial papers; (b) discounting commercial papers; and (c) other forms, such as relending against credit documents in order to support credit institutions' temporary liquidity difficulties and to support economic development. SBV announces the refinancing rate in line with macroeconomic and market conditions as well as overall monetary policy's targets.

3. Reserve Requirements

Reserve requirements have been managed to achieve the government's macroeconomic targets while also serving additional policy objectives with diverse rates of reserve requirements. Reserve requirements are differentiated based on the deposit currency (VND or foreign currencies), the maturity of deposits, the type of credit institutions (people's credit funds, microfinance organizations, banks for government policy, Bank for Agriculture and Rural Development, co-operative banks, etc.), banks focused on priority sectors, banks under special control and banks participating in restructuring plans. Reserve requirements for long-term deposits (more than 12-month maturity) for both VND and foreign currencies are kept at a lower level than those for short-term deposits (under 12-month maturity); and lower for banks that actively provide loans for agricultural and rural development.[46] The required reserve ratios for foreign currency deposits are usually set higher than those of VND deposits to support the de-dollarization policy. Since 2011, the SBV has stipulated the reserve requirement ratio of 1 percent for all deposits of credit institutions based abroad. However, credit institutions under special control are not subject to reserve requirements, while a 50- percent reduction in the reserve requirement ratio is applied to approved recovery plans for credit institutions participating in the restructuring of weak credit institutions.

4. Interest Rate Caps

The SBV started to re-impose caps for deposit and lending interest rates after allowing full interest rate liberalization in 2002, when credit institutions – especially weak banks – entered the interest rate hike race during 2008-2011. The ceilings were put in place to reduce lending rates to support businesses, especially small- and medium-sized enterprises, facing difficulties in production. As of end-2018, interest rate ceilings are still in use in a selective manner.

4.1 VND Deposit Rate Cap

With high inflation and intensifying competition for customers' deposits among commercial banks, which threatened macroeconomic stability in 2011, the SBV instituted a VND deposit interest rate cap. The annual interest rate for VND deposits, including promotion in any form, is capped at 14 percent. As inflation was on a steady downward trend while economic performance was weak from 2012 to 2014, the SBV gradually relaxed the cap on VND deposit interest rates for medium- and long-term deposits. The cap on the VND interest rate for deposits with terms over 12 months was lifted in June 2012, while the cap on deposits with terms of over six months was lifted in March 2014. However, the ceiling for deposits with terms ranging from one to

[46] To benefit from lower reserve requirement ratios, banks need to comply with criteria of actively providing loans for agricultural and rural development as specified in legal documents.

six months was lowered from 14 percent to the current level of 5.5 percent; and the cap on deposits with terms of less than one month was cut down from 5 percent to the current level of 1 percent. These measures are meant to help lower the lending rates to support enterprises that are faced with difficulties.

4.2 VND Lending Rate Cap

In 2012, as part of a series of efforts to support business activities in accordance with the government's objectives, the SBV started setting ceilings for VND short-term lending rates applicable to priority sectors including agricultural and rural development, exports, industry support, and the high-tech and SME sectors. Originally, the short-term lending rate cap was set as the deposit rate cap plus a margin. Later, the cap was set directly at a specific rate, irrespective of deposit rate cap. The lending rate cap has been reduced in phases from 15 percent in 2012 to 6.5 percent today, consistent with the downward trend of VND deposit cap. For loans in other non-priority sectors, credit institutions set lending interest rates at negotiable levels.

4.3 USD Deposit Interest Rate Cap

The USD deposit interest rate cap, together with the VND deposit interest rate policy and the tightened USD lending policy, is a strong measure to fight dollarization, reduce foreign currency hoarding, and help stabilize the foreign exchange market by ensuring a reasonable gap between VND and USD interest rates. Before 2007, the ceiling for USD deposit interest rates was applicable only to organizations, but was lifted in 2007. In 2011, the USD interest cap was introduced again, to apply to both organizations as well as individuals. The cap has been reduced from time to time, and currently stands at 0 percent for the deposits of both organizations as well as individuals.

5. Exchange Rate

Before 2016, the SBV regulated the exchange rate by announcing the daily average interbank exchange rate and trading band. From 1999-2007, the trading band was relatively narrow (from +/-0.25 percent to +/-0.75 percent) but from 2008, the band was widened (from +/-1 percent to +/-5 percent) allowing more fluctuations in the FX market. In order to stabilize the public expectation on the exchange rate, from 2011-2015, the SBV set out an annual target of VND depreciation at the beginning of the year (around 2 percent on average). However, since the average interbank exchange rate was adjusted only when there was strong depreciation pressure on the VND, the old exchange rate management mechanism was very susceptible to speculation, especially when the economy faced pressure arising from a high trade deficit, high inflation or complex developments in the world economy. Therefore, in January 2016, the SBV implemented a new system in where the central USD/VND rate was announced on a daily basis. This rate is based on three benchmarks: (i) the weighted average interbank exchange rate; (ii) the exchange rate of a basket of eight foreign currencies of countries having important trade, investment and borrowing-lending links with Vietnam; and (iii) macroeconomic, monetary balances and the monetary policy target. With a trading band of +/- 3 percent, the central exchange rate now moves in both directions, containing foreign currency speculations and hoarding. The SBV has also conducted forward sales of USD to commercial banks short of foreign exchange and with dollar demands, to send a message that the supply of USD to credit institutions is assured.

6. Annual Credit Growth Rate

The SBV's objective for credit management is to control credit growth rate in line with other instruments to meet the objectives of the banking sector as a whole, as set by the government. Before 2010, the SBV only provided general guidance for credit institutions to control credit growth and improve credit quality. In 2010-2011, the SBV started to announce a specific credit growth target for the whole system. Starting in 2012, in line with the economic growth and inflation targets set out by the National Assembly and the government, the SBV sets the annual credit growth target and allocates credit growth targets to specific credit institutions. In its implementation, it considers adjusting credit limits for certain credit institutions on the basis of their financial status, the demand and credit expansion capability, in a safe and effective manner.

2. **In short, a suite of monetary policy tools has been used in a flexible manner to achieve monetary policy objectives.** During high inflation periods in 2007-2008 and 2010-2011, policy interest rates (refinancing rate, rediscount rate and base interest rate[47]), reserve requirement ratios and OMOs were adjusted regularly in line with the movement of inflation rates. In terms of credit management, during 2008-2011, the SBV set the threshold for the outstanding loans to some non-productive sectors (securities, real estate and the like). In 2011, in an effort to contain the deposit rate hike of some banks facing liquidity shortages, the SBV set the ceiling on VND deposit interest rates. The interest rate cap for VND deposits has been kept until now although the SBV deregulated the cap on term deposits of more than six months while cutting the ceiling on less-than-six-month deposits, as the pressure of inflation subsided.

3. **Since 2012, as inflation has been gradually contained, the refinancing rate, rediscounting rate, reserve requirement ratios, and the OMO repo rate have remained relatively stable, with monetary policy aimed at cutting interest rates to support economic activity.** The SBV has gradually lowered the maximum VND lending rate applied to five priority sectors. Additionally, the policy of target credit growth and credit growth allocation to specific credit institutions have been key tools. To support exchange rate stabilization, in addition to the change to the central exchange rate system in 2016, the SBV has actively regulated the volume and interest rates of SBV bills, and maintained an appropriate gap between VND and USD interest rates through regulations on VND and USD interest rate caps, and intervening in foreign currency purchasing-selling operations.

[47] The base interest rate was introduced by the SBV in 2000. Originally, it was an indicator for credit institutions to set their lending rate cap for their customers, but from 2002-2008, it was used as a reference interest rate as credit institutions were allowed to set their lending rates based on the capital supply and demand in the market and the credit ratings of the borrower. However, as inflation began soaring in 2008, the base interest rate once again worked as an interest rate cap in the market from May 2008 to 2009. Credit institutions' VND deposit and lending interest rates could not exceed 150 percent of the base interest rate set by the SBV. Since then, the base interest rate was used as a reference indicator again when VND lending interest rates are gradually allowed to be negotiable, and then was abandoned officially in 2012 after the SBV's last announcement on monthly base interest rates in 2010.