



AMRO Annual Consultation Report

Vietnam - 2024

ASEAN+3 Macroeconomic Research Office (AMRO)

March 2025

Acknowledgments

1. This Annual Consultation Report on Vietnam has been prepared in accordance with the functions of AMRO to monitor, assess and report on its members' macroeconomic status and financial soundness, to identify relevant risks and vulnerabilities, and to assist them in the timely formulation of policy to mitigate such risks (Article 3 (a) and (b) of the AMRO Agreement).
2. This Report is drafted on the basis of the Annual Consultation Visit of AMRO to Vietnam from September 11-24, 2024 (Article 5 (b) of the AMRO Agreement). The AMRO Mission team was headed by Sumio Ishikawa Group Head and Lead Economist. Members included Wanwisa Vorrarikulkij, Country Economist for Vietnam; Jade Vichyanond, Backup Economist; Thanh Trung Vu, Associate Economist; Ginanjar Wibowo, Fiscal Sector Specialist; Wen Yan (Ivan) Lim, Financial Sector Specialist; Dac Toan Nguyen, Associate; and Van Duc Tran, Associate. AMRO Director Kouqing Li and Chief Economist Hoe Ee Khor also participated in key policy meetings with the authorities. This AMRO Annual Consultation Report on Vietnam for 2024 was peer reviewed by economist group from AMRO's country surveillance, financial surveillance, fiscal surveillance, and policy review teams; endorsed by Jiangyan Yu, Senior Economist, Policy and Review Group; and approved by Dr Hoe Ee Khor, AMRO Chief Economist.
3. The analysis in this Report is based on information available up to November 6, 2024.
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 judgments 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

1. The Vietnamese economy has continued to gain momentum in 2024, but the recovery remains concentrated in export-oriented sectors. The economic recovery has been led by manufacturing exports, a rebound in the hospitality sector, and resilient FDI inflows. Meanwhile, households have been cautious in their spending, reflected in the stagnation in wholesale and retail sales, which weighed primarily on micro, small, and medium enterprises (MSMEs). Super Typhoon Yagi caused extensive damage to roads, ports, agricultural areas, and factories in the northern provinces, impacting the manufacturing sector. AMRO forecasts the Vietnamese economy to grow at 6.5 percent in 2024, before strengthening to 6.7 percent in 2025.

2. Consumer price inflation remains within the inflation target ceiling. Although food prices are expected to rise in the coming months with disruption to agricultural production by typhoon Yagi, inflationary pressure remains contained, owing to weak domestic demand, administered prices, adequate domestic food production, and the recent decline in global oil prices. Headline inflation is projected to rise from 3.3 percent in 2023 to 3.8 percent in 2024, remaining well below the authorities' target ceiling of 4.5 percent.

3. The balance of payments (BOP) was in deficit in the first half of this year due to large capital outflows. The rebound in exports supported the current account surplus, while resilient FDI inflows continued to bolster the financial account. However, forex intervention in support of the VND and large unrecorded outflows reflecting the higher US interest rates than the Vietnamese ones, and the purchase of virtual assets overseas brought the BOP into a deficit, leading to a decline in international reserves. As of the latest data, foreign reserves stood at USD83.3 billion in July 2024, 2.5 times short-term external debt.

4. Vietnamese authorities have employed monetary and fiscal measures judiciously to support the economic recovery. The government continued the 2-percent reduction of VAT, further reduced land rent and environmental taxes for gasoline, oil, and grease, as well as re-introduced deferrals of taxes and land rent in the second half of this year.¹ The SBV has also kept operating interest rates low, lowered the open market operation (OMO) rates, increased the indicative credit growth target, and extended the loan moratorium program by another six months. The state-owned commercial banks (SOCBs) reduced short-term deposit and lending rates to guide interest rates in the market.

5. Risks to the growth outlook are tilted towards the downside. The ongoing robust recovery of Vietnam's exports could be derailed by external risks stemming from a weaker-than-expected consumer demand in the U.S., a sharp growth slowdown in Europe, or slower growth in China. The export outlook also faces uncertainty owing to likely increase in the U.S. import tariffs under the incoming US administration.

6. The financial sector faces heightened credit risk. Although the banking sector's NPL ratio has stabilized, credit risk remains high due to the uneven economic recovery and damages from the typhoon. The loan moratorium program freezes borrowers' loan classifications and allows them to defer principal repayments on existing loans, while enabling them to secure new credit from banks. The housing market prospects could be clouded by delays in the implementation of the new real estate-related laws. Amid the housing market challenges, some developers are struggling with debt repayment and refinancing.

7. Vietnam's growth potential is hindered by lingering structural challenges. Infrastructure development in Vietnam has not kept pace with rapid economic growth in the past decade. The sluggish pace of public investment is attributed to delays in land acquisition and clearance, inconsistencies in regulations, lengthy and complex administrative procedures, and limited planning capacity. The country has also faced a mismatch between workforce skills

¹ The government implemented these measures following approval from the National Assembly.

and industry requirements. The under-development of domestic supporting industries and MSMEs has hindered the country's progress in moving up the global value chains.

8. Emerging challenges increasingly threaten Vietnam's macro-financial stability. First, cyber threats have evolved and become more complex, with serious attacks on even large corporations with advanced cyber security systems. Second, more frequent extreme weather conditions have caused mounting economic losses. Lastly, the rapidly aging population has raised concerns about an impending shrinking labor force and the long-term sustainability of the Social Security Fund.

9. Given an uneven economic recovery, the government should recalibrate the fiscal support measures to target MSMEs and low-income households and speed up disbursement of budgeted capital spendings. Vietnam's ample fiscal space provides room for the government to extend additional support measures to vulnerable segments. Moreover, the disbursement of public investment can be expedited to boost short-term growth and strengthen long-term growth potential.

10. Structural challenges in the fiscal sector should be addressed. State revenue management should be strengthened further by enhancing the enforcement and compliance of tax laws, simplifying the tax system, broadening the revenue base, and minimizing tax exemptions. Revising the State Budget Law with the aim of reducing the time for the settlement of the government accounts and minimizing carry-over spending should be also considered.

11. Given that inflationary pressure is contained, and domestic demand is weak, the monetary policy stance should remain accommodative. Consumer price inflation is expected to remain below the target ceiling. However, domestic demand remains weak and MSMEs are still struggling to recover. The Fed's recent rate cut has reduced pressure on the Vietnamese dong and mitigated the risk of speculative capital outflows. Hence, monetary policy should continue to support the recovery in local economic activity.

12. The mission commends SBV's ongoing efforts to modernize the monetary policy framework. As Vietnam looks to deepen financial market development in tandem with rapid economic development, monetary policy reform should phase out the use of quantitative credit targets and move toward a more market-based interest rate approach. The SBV's primary focus should be on maintaining consumer price inflation below the target ceiling, while continuing to enhance exchange rate flexibility as a buffer against external shocks.

13. There is room to enhance banking system soundness. Commercial banks should accumulate more financial buffers to withstand unexpected shocks while bad debt management mechanisms should be improved to allow more efficient debt recovery processes. Commercial banks should continue to improve their corporate governance, risk management framework, and internal risk control system. The banking resolution framework should be strengthened further to ensure timely and orderly resolution of banks in distress.

14. Additional measures should be taken to mitigate the financial distress of developers and strengthen governance in the real estate sector. Developers should continue diversifying their sources of funding. Prudential measures such as loan-to-value ratio, debt service to income ratio, and credit concentration limits should be considered. Banks are encouraged to collaborate with viable developers to assess challenges, including the liquidity conditions of real estate development projects, so as to develop appropriate solutions in compliance with domestic laws and regulations, while ensuring the stability of the banking system.

15. Concerted efforts should be made to promote inclusive and sustainable development. The authorities should continue upgrading infrastructure and improving labor productivity and MSMEs' capabilities. Vietnam's rapid digitalization necessitates more pro-active government policies to prevent cyber threats. More efforts should be directed towards improving coordination in implementing climate change response activities and in effectively mobilizing green finance. Enhancing financial sustainability and transparency of the social insurance fund is crucial to prepare for the challenges posed by a rapidly aging population.

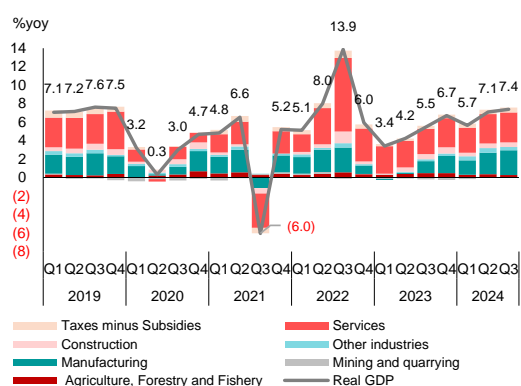
A. Recent Developments and Outlook

A.1 Real Sector Developments and Outlook

1. The Vietnamese economy continued to gather momentum in the first three quarters of this year, but the recovery was still concentrated in export-oriented sectors. GDP growth accelerated to 6.8 percent year-on-year (yoy), led by the recovery of exports and manufacturing (Figure 1), especially in the electronics and textile industries. The construction sector also benefited from resilient inflows of FDI, despite bottlenecks in the housing market. The hospitality sector expanded on the back of a resurgence in tourist arrivals. Thanks to improving exports, the labor market saw the early stages of recovery after the sharp contraction in 2023. However, weak linkages between export-oriented multinational corporations and local firms limited the spillover effects of export recovery on local businesses. Domestic demand, primarily driven by employment and SME operations, remained stagnant. Vietnamese households were cautious in their spending, and private investment by local firms saw only marginal expansion. Additionally, in early September, Super Typhoon Yagi brought torrential rains, flooding, and landslides, causing casualties and extensive damage to roads, ports, agricultural areas, and factories in the north, including Hanoi and Hai Phong.

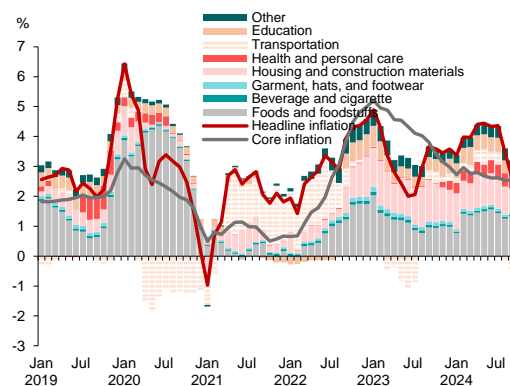
2. The Vietnamese economy is projected to grow at 6.5 percent in 2024 before strengthening to 6.7 percent in 2025. Underpinned by a gradual improvement of manufacturing production and employment, domestic economic activity is expected to gain momentum in the second half of 2024. Vietnam’s manufacturing sector will continue to benefit from increasing new orders and the current global semiconductor cycle upturn. However, the recovery has been weakened temporarily by Typhoon Yagi, which caused damaged to manufacturing, agricultural production, and logistics in the northern regions. Given Vietnam’s myriad free trade agreements, close geographical proximity with China and ASEAN, and a young workforce, the country is an attractive FDI destination. Incoming FDI is expected to generate export revenue for Vietnam and stimulate local demand through investment and employment. Construction activity is expected to be further boosted by public investment and repair works toward the end of the year, although the housing market, which is awaiting the implementation of regulations under the new real estate laws, is anticipated to rebound in the second half of 2025.

Figure 1. GDP Growth



Source: GSO; CEIC; AMRO staff calculations

Figure 2. Consumer Price Inflation



Source: GSO; CEIC; AMRO staff calculations

3. Consumer price inflation was increased in the first half of 2024 due to supply shocks but has remained below the target ceiling. Headline inflation increased from 3.6 percent in December 2023 to 4.4 percent in July 2024, driven primarily by rising food and

dining prices, fueled by the effects of El Niño and India's rice export ban, which resulted in increased global rice prices (Figure 2). Additionally, the depreciation of the Vietnamese dong (VND) and higher shipping costs further pushed up import prices, particularly for fuels and construction materials. However, since August, headline inflation has eased, supported by administered prices, adequate domestic food production, and a decline in global oil prices. At the same time, core inflation slowed from 3.0 percent to 2.7 percent over the past 10 months. Looking ahead, headline inflation will likely rise in the last quarter of 2024 reflecting a recovery in domestic demand and the impacts of the Typhoon Yagi on supply. Inflation is forecast to rise from 3.3 percent in 2023 to 3.8 percent for the whole of 2024, remaining below the government's target ceiling of 4.5 percent.

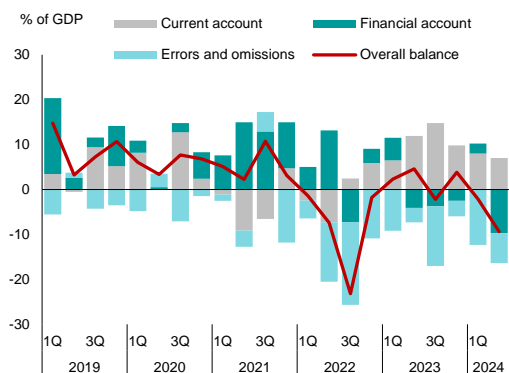
A.2 External Sector and the Balance of Payments

4. Vietnam's export sector has performed strongly so far this year, thanks largely to a rebound in demand for the country's major exports. Exports have rebounded strongly from the previous year, registering a 14.7 percent (yoy) growth for the first 10 months, as the upturn in the global electronic cycle has boosted exports of phones, computers, and related components. Exports of wood products surged by 24.2 percent (yoy) over the same period, driven by strong furniture demand from the U.S., which accounted for around half of the industry's exports, while textile and garment exports have also recovered, albeit at a more moderate pace. On the services side, the number of foreign tourists started to plateau around Q1 this year, at around 80 percent of the pre-pandemic level, as the return of Chinese tourists—China was the largest source of foreign arrivals before the pandemic—has been lackluster compared to foreign tourists from elsewhere.

5. Despite uncertainties surrounding the ongoing political transition, FDI inflows have been resilient this year on the back of global supply chain reconfigurations. FDI inflows in the first ten months grew by 8.8 percent (ytd, yoy), as Vietnam continues to be an attractive manufacturing hub amid growing U.S.-China tensions. FDI registration is showing even stronger growth, growing by 22.6 percent (ytd, yoy) over the same period. Manufacturing remains the main target for foreign investment, constituting around 70 percent of FDI applications. Meanwhile, the real estate sector appears to be benefiting from the revision of the land law in January 2024, as reflected in the robust growth of FDI registration thus far this year following a subdued record in 2023.

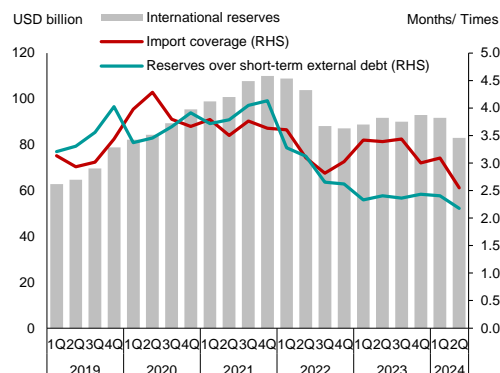
6. Despite a significant trade surplus and strong FDI inflows, the balance of payments was in deficit this year due to large capital outflows. The rebound in exports supported the current account surplus, while resilient FDI inflows continued to bolster the financial account. However, large unrecorded outflows (E&Os), due partly to the high US interest rates and the strong US dollar in the first half of 2024, brought the balance of payments into a deficit of USD11.5 billion in the first half of this year (Figure 3). As of the latest data, foreign reserves stood at USD83.3 billion in July 2024, equivalent to 2.5 times of short-term external debt or 2.9 months of goods and services imports (Figure 4).

Figure 3. Balance of Payments



Source: SBV; CEIC; AMRO staff calculations

Figure 4. International Reserves

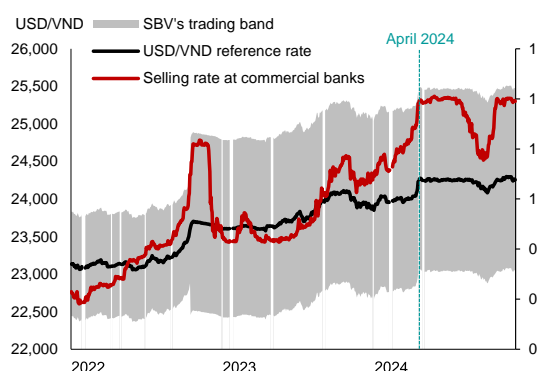


Source: SBV; World Bank; CEIC; AMRO staff calculations

A.3 Monetary Conditions and Financial Sector

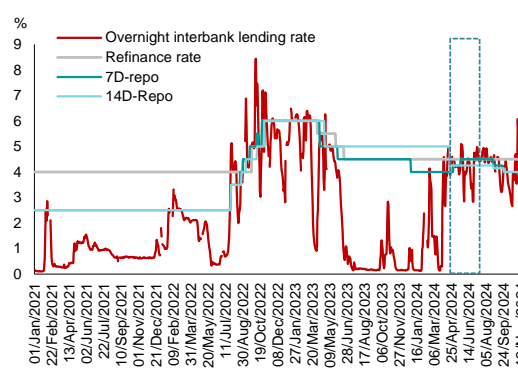
7. The SBV intervened in the foreign exchange (FX) market to slow down the exchange rate depreciation in several times in 2024. The VND depreciated by around 4.5 percent (ytd) and approached the SBV’s FX upper trading band in April 2024 (Figure 5). To stabilize the currency, the SBV sold U.S. dollars, while withdrawing local currency liquidity through open market operations (OMOs). The OMO bidding rate for the 14-day repurchase agreement (repo) was set at a range of 4.00 percent to 4.25 percent from April 22 to April 26. Subsequently, this rate was increased to 4.5 percent for the period between May 23 – June 3. This adjustment aimed at narrowing the gap between US and local interest rates in the interbank market. Throughout these periods, the 7-day repo bidding rate remained constant at 4.0 percent (Figure 6). Interbank lending rates surged to 4 percent in April 2024 from less than 1 percent in the first quarter of 2024 while the 10-year government bond yield rose to 2.8 percent in June 2024 from 2.2 percent in March 2024. In early August 2024, as the depreciation pressure on the Vietnamese dong eased, the SBV ceased its liquidity absorption through issuance of SBV bills and reduced the OMO bidding rates.

Figure 5. The VND and the SBV’s FX Band



Source: SBV; Techcombank; Haver Analytics; AMRO staff calculations

Figure 6. Overnight Interbank Lending Rate and Bidding Rates of Repo Agreements



Source: SBV; Haver Analytics; AMRO staff calculations

8. The authorities continue to maintain accommodative financial conditions to support real activity. The SBV has maintained operating interest rates since June 2023, including caps on short-term bank deposit and bank lending rates to priority sectors, alongside reducing the OMO rates and halting the issuance of SBV bills recently. The annual indicative credit growth target was also increased to 15 percent in 2024 from 14.5 percent in 2023. The

special loan moratorium program² was extended by another six months and will now end in December 2024. Furthermore, SOCBs cut their lending and deposit rates further this year, aiming to lower lending rates across the banking industry. Despite the eased monetary conditions, loan demand has not kept pace with relatively strong economic growth. Bank loans grew by 15.7 percent (yoy) or 7.3 percent (ytd) in August 2024, well below the government's annual indicative credit growth target due to weaker credit demand. (Figure 7, 8)

9. The asset quality of commercial banks has weakened while profitability has declined. The non-performing loan (NPL) ratio reached 4.8 percent at the end of July 2024, up from 2 percent at the end of 2022.³ Total restructured loans under the Circular 02/2023⁴ amounted VND114.5 trillion in July 2024, accounting for 0.8 percent of the banks' total outstanding loans. In response to weakening credit quality, commercial banks set aside loan loss provisions.⁵ The lingering effects of slow credit growth and rising costs of impaired loans in 2023 may continue to dampen bank profitability this year. The average return on assets of commercial banks declined slightly to 1.3 percent at end-2023 from 1.4 percent at end-2022. Meanwhile, the average return on equity declined to 14.2 percent in December 2023 from 15.8 percent in December 2022.

10. However, banks continue to maintain adequate capital and liquidity buffers. Reflecting elevated risks and weaker profits, the capital adequacy ratios (CAR) of most banks dropped in 2023 but remained above the regulatory minimum requirement of 8 percent (Selected Issue 1. Whether Vietnamese Banks Can Pass Credit Stress Test). The average CAR of SOCBs stood at 10 percent while the average CAR of private joint-stock commercial banks (JSCBs) was 12 percent at the end of 2023.⁶ Additionally, there was no sign of liquidity shortage in the financial system, as reflected in the overnight interbank lending rate that hovered at around the SBV's OMO rate. Total banking sector deposits increased by 11.1 percent (yoy) in May 2024, of which deposits from individuals increased by 5.8 percent. The average loan-to-deposit (LTD) ratio increased slightly to 78.9 percent in May 2024 from 76 percent in December 2023. In addition, amid the lingering public concern about one large, troubled bank which is closely linked to some real estate scandals, the SBV has kept the bank under its special control and enhanced supervision and provided deposit guarantee and special loans to the bank in early 2024 primarily to protect depositors' interests.

11. Despite remaining well below its peak in 2019, the real estate sector has shown early signs of improvement in 2024, supported by the passage of three major laws.⁷ In 2022 and 2023, property developers and real estate-related businesses faced several

² Circular 02/2023/TT-NHNN, issued on April 23, 2023, permits credit institutions to reschedule debt repayment for both principal and/or interest at the borrower's request, without reclassifying the loan category. To be eligible, borrowers must demonstrate their capacity to repay the restructured debt, including both principal and/or interest, within the newly agreed repayment period as outlined in Article 04 of Circular 02/2023/TT-NHNN. Credit institutions are required to make full provisions for any restructured debts by December 31, 2024. The program was originally set to end in June 2024.

³ The NPL ratio, including loans sold to Vietnam Asset Management Company (VAMC), also flattened at 6.9 percent in the first half of 2024.

⁴ Circular 06/2024/TT-NHNN, introduced on June 18, 2024, revised and supplemented Circular 02/2023/TT-NHNN. Circular 06/2024 extended loan rescheduling under Circular 02/2023/TT-NHNN for another six months, instead of expiring on June 30, 2024. Circular 02/2023/TT-NHNN governed the restructuring or rescheduling of an individual loan, rather than the total loan of a customer. Consequently, a customer with multiple debts may have certain debts restructured while retaining their original debt classification, while other debts that are not restructured will also maintain their respective classifications in accordance with current regulations.

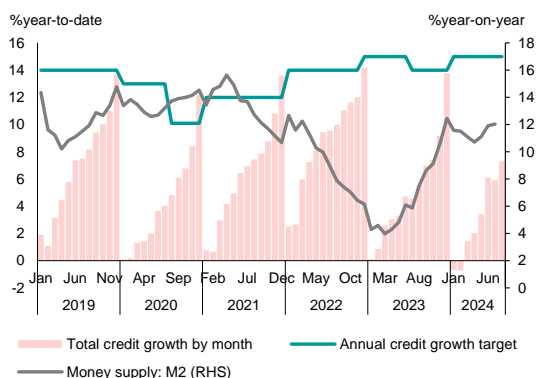
⁵ As of Q4 2023, 26 of 27 listed banks have increased their loan loss provisions, of which most SOCBs and a few medium-sized JSCBs maintain the provision coverage ratio of over 80 percent.

⁶ Vietnam's banking sector has a lower Capital Adequacy Ratio (CAR) compared to that of regional peers. As of June 2023, Vietnam's CAR stood at 11.4 percent, compared to Indonesia's 25.2 percent, Malaysia's 18.9 percent, the Philippines' 16.2 percent, and Cambodia's 22.9 percent.

⁷ Vietnam's real estate sector experienced rapid development in the past decade as the middle-class moved into cities seeing rapid economic development. Although many home buyers postponed their home purchase during the Covid-19 pandemic, real estate developers continued to supply real estate properties by getting finance from the corporate bond market in addition to bank loans.

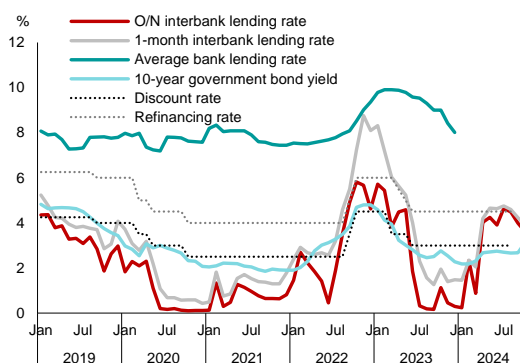
difficulties, including tight financial conditions, weak investment sentiment in the corporate bond market, subdued housing demand, and legal bottlenecks that resulted in project suspensions or delays. The absorption rate⁸ declined to around 33 percent in 2023 from its peak at 69 percent in 2019. However, in 2024, the housing market has seen a slight improvement, with the number of housing transactions rising to 6,200 units in Q1 2024 from 2,700 units in Q1 2023.⁹ Public confidence in the corporate bond market has stabilized to some extent, with a slight increase in demand for corporate bonds, easing financing conditions for some real estate developers. The National Assembly passed amended laws on land, housing, and real estate business in January 2024¹⁰. While the laws took effect on August 1, 2024, the associated decrees, regulations, and guidelines are still being drafted. It will take time for the new laws and their subordinate regulations to become effective, particularly the ones on land valuation. Thus, while these new laws have the potential to drive market recovery and enhance investor confidence by addressing legal bottlenecks¹¹, their impact on the market is expected to become evident only at the end of 2025.

Figure 7. Bank Loan Growth



Source: SBV; CEIC; AMRO staff calculations
Note: Loan growth in this chart is in yoy terms, not YTD.

Figure 8. Interest Rates



Source: SBV; Hanoi Stock Exchange; CEIC; AMRO staff calculations

A.4 Fiscal Sector

12. The fiscal deficit in 2024 is projected to decrease slightly to 2.6 percent of GDP¹² from 2.7 percent in 2023¹³. Revenue collection is projected to increase to 17.3 percent of GDP in 2024 from 17.2 percent of GDP in 2023, reflecting robust economic recovery¹⁴,

⁸ The absorption rate refers to the share of available properties that are successfully sold during a period.

⁹ Source: Vietnam Association of Realtors

¹⁰ Together with amended laws, the government has adopted a series of measures to support the real estate sector. For example, the government continues its social housing development program, aiming to build one million affordable homes by 2030. Despite slow disbursement, the VND120 trillion credit package continues to be rolled out, offering preferential loans to both developers and homebuyers.

¹¹ Key legal amendments such as more transparent land acquisition and market-based land valuation are expected to address legal bottlenecks (Box C. Vietnam's Laws on the Real Estate Sector).

¹² In the Ministry of Finance's first estimate of the 2024 budget operations, the fiscal deficit is projected to be 3.4 percent of GDP. This estimate includes expenditures budgeted for 2024 that may be carried over to 2025, but excludes expenditures carried over from previous fiscal years and spent in 2024. In contrast, the final budget operations report, released with an 18-month lag, excludes expenditures carried over to 2025 but includes those from previous fiscal years spent in 2024. To account for this discrepancy between the official estimate and the final budget operations, AMRO provides estimates for 2024 expenditures using the same coverage as the final budget operations report.

¹³ These projections have already incorporated the carry-over expenditures from the previous years and excluded the carried over to the subsequent years. As carry-over expenditures are released officially 18 months after the end of the fiscal years, AMRO's estimates were used in these projections (see more detail about the carry-over expenditures in Selected Issue 2).

¹⁴ In particular, manufacturing industries increased their production by 9.8 percent in the first nine months of 2024 year-on-year, which may have increased CIT collection. More specifically, rubber and plastic product, chemicals products, and textiles, travel and tourism industries increased their production by 29.8 percent, 16.9 percent, 12.8 percent, and 6.9 percent, respectively. Additionally, total export and import value also reached to USD579 billion or increased by 16.3 percent. As a result, state revenue collection rose to VND 1,448.2 trillion, by 18.3 percent yoy in the first nine months of 2024.

improved tax administration¹⁵, and increased real estate related revenue following the amended land law taking effect¹⁶. These factors will offset the revenue losses from the 2-percent VAT rate deduction¹⁷ and a reduction of the environmental protection tax. Nevertheless, the government still faces challenges in reducing tax arrears.¹⁸ Total expenditure is expected to grow by 11.7 percent mainly driven by the implementation of a 30 percent increase in basic salary from July 1, 2024.¹⁹ Although the rate of capital expenditure disbursement is expected to be higher than last year, a considerable portion of capital expenditures is expected to be carried over to next year²⁰. (Figure 9)

13. Despite somewhat higher capital investment and the ongoing salary reform, the fiscal deficit is expected to narrow slightly in 2025.²¹ Government revenue is projected to continue growing, partly thanks to improvements in tax administration through digitalization. Nevertheless, the revenue-to-GDP is expected to decline to 17.1 percent of GDP as nominal GDP growth outpaces revenue growth. Given the robust economic recovery, tax relief measures – including the 2-percent reduction in VAT as well as tax and land rent deferrals – are expected to be discontinued. Additionally, the increase in official land price benchmarks, as outlined in the amended Land Law, is expected to boost government revenue. Meanwhile, government expenditure is projected to increase in 2025 as the salary reform will continue²², and capital expenditure will also rise. The government will continue to improve efficiency in non-prioritized recurrent expenditure²³ and reprioritize government spending toward capital expenditures, as 2025 marks the final year of the Medium-term Public Investment Plan (2021-2025). Given a positive output gap, a neutral fiscal stance in 2025 is deemed appropriate to prevent exacerbating inflationary pressures.²⁴

¹⁵ Electronic invoices were implemented on businesses in the restaurant, hotel, gold trade, and gasoline retail distributing sectors. The government started using a mobile application for tax filing and payments, and AI technology to detect tax evasion and fraud. It also started collecting tax from foreign online platforms, such as Amazon, Google, and Facebook.

¹⁶ Please refer to Box C. Vietnam's Laws on the Real Estate Sector: Key Amendments.

¹⁷ The Ministry of Finance's estimate on revenue loss in 2024 due to the 2-percent reduction in VAT and environmental protection tax is around VND 91.5 trillion, composing VND42.5 trillion from the environmental protection tax and VND49 trillion from the VAT rate reduction.

¹⁸ According to Ministry of Finance data, total tax arrears increased by 36 percent year-on-year in 2022, reaching VND 158.9 trillion (1.4 percent of GDP). The government can only write off the tax arrears from the system after 10-15 years and needs National Assembly's approval.

¹⁹ The 30 percent basic salary increase amounts to approximately VND 226 trillion in the second semester of 2024. Of this amount, VND 152 trillion will be sourced from the salary reform fund, while the remaining VND 74 trillion from the 2024 budget. The remaining amount in the salary reform fund will be spent in 2025-2026.

²⁰ While the Resolution No. 01/NQ-CP dated January 5, 2024 intended to enhance capital expenditure disbursement at least to 95 percent of the budget by the end of 2024, actual capital expenditure disbursement was only 47.3 percent of the budget up to September 2024. To address the sluggish disbursement, the government issued Prime Minister order No. 104/CD-TTg, dated October 8, 2024, to accelerate capital expenditure disbursement for the remainder of 2024.

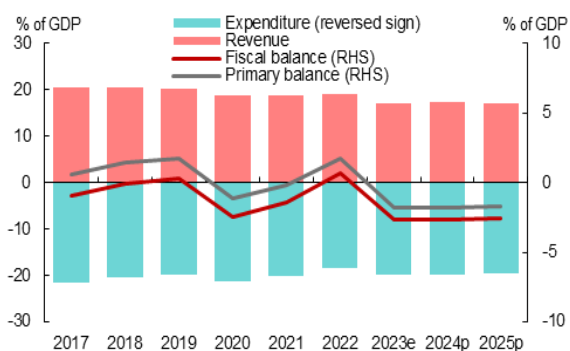
²¹ AMRO's estimation for 2025 fiscal deficit is 2.5 percent to GDP by incorporating the estimation on carry-over expenditure. Meanwhile, the fiscal deficit in 2025 government's budget is 3.8 percent GDP as it does not incorporate the carry-over expenditure from the previous year and to next year.

²² Since 2018, the government has committed to gradually reform the salary system for government officials to align with job positions, responsibilities, and living costs. This reform aims to adjust the salary structure, with basic salary accounting for 70 percent and allowances for 30 percent. However, the implementation has encountered several difficulties and delays. Against this backdrop, the government has decided to increase the basic salary of all civil servants by 30 percent in 2024 instead, while exploring the most practical options for comprehensive salary reform. In addition, bonus payments, with the total amount of 10 percent of the basic salary fund, will be paid to civil servants as a part of the salary reform, and is expected to continue in 2025.

²³ Non-priority current expenditures include spending on seminars, conferences, business travels, and luxury vehicles for officials.

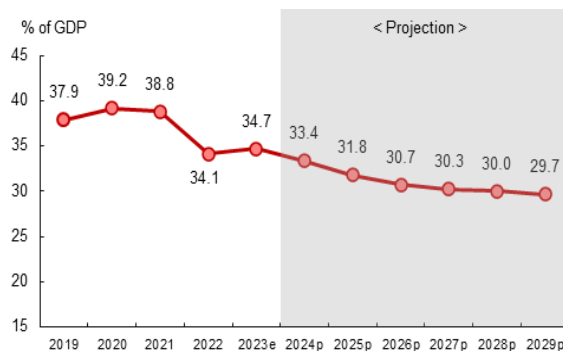
²⁴ AMRO assesses the fiscal stance by fiscal impulse, measured by changes in the structural primary balance.

Figure 9. Fiscal Balance



Source: MOF; AMRO staff projections
Note: 'e' = estimation; 'p' = projection

Figure 10. Medium-term Public Debt Projections



Source: MOF; AMRO staff calculations and projections

14. The fiscal deficit and public debt-to-GDP ratio are projected to remain at relatively low levels over the medium term, supported by enhanced revenue mobilization, improved spending quality, and prudent public debt management. The fiscal deficit is projected to reach 2.5 percent of GDP by 2029. Vietnam is in the process of reforming its tax system by 2030. The reform aims to modernize the tax system, enhance revenue mobilization, and streamline administrative procedures. Several laws related to excise tax, PIT, and CIT are being reviewed and will be amended in the near future²⁵, while the new Law on Value Added Tax was implemented in November 2024. The government will continue to enhance the efficiency of non-prioritized spending, reform civil servants' salary structure²⁶, and focus more on infrastructure development. According to the medium-term fiscal plan, the government has set a budget revenue target of around 17 percent of GDP²⁷. AMRO projects the public debt-to-GDP ratio to trend down from 33.4 percent in 2024 to 29.7 percent in 2029 (Figure 10), well below the 60-percent ceiling set by the National Assembly.

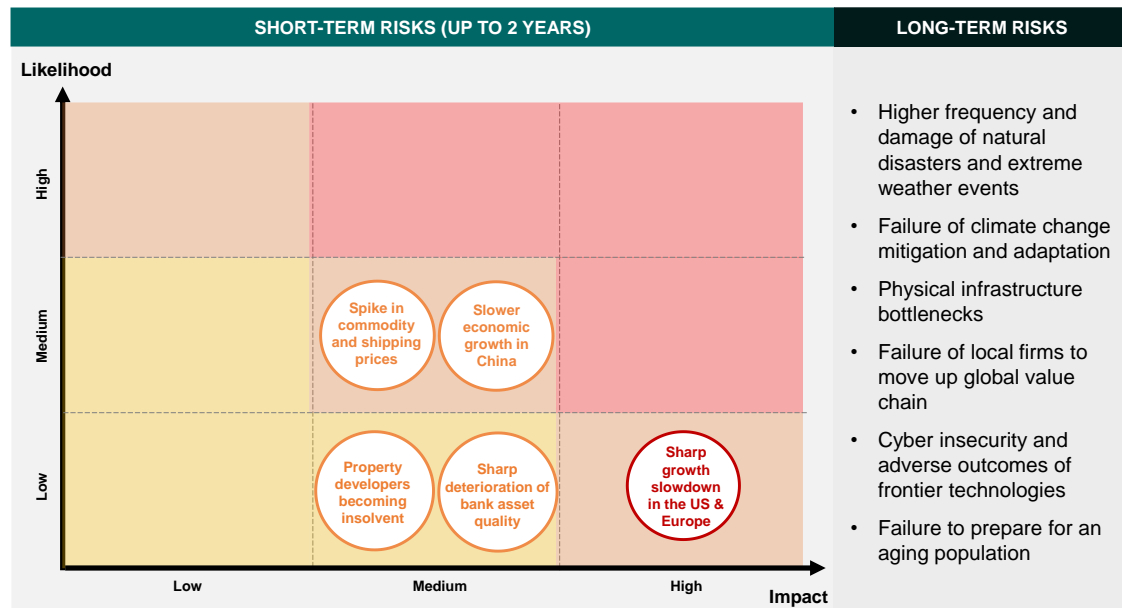
²⁵ The new VAT law has been in effect since November 26, 2024. Key changes include, but not limited to, adjustments to taxable items under excise tax and VAT, changes in the personal income tax deduction, and the elimination of certain corporate income tax incentives.

²⁶ According to the Politburo Decision No. 83-KL/TW dated June 21, 2024, the proposal of new salary table must be submitted to the Central Communist Party Committee by 2026.

²⁷ Prime Minister's Decision No. 368/QĐ-TTĐ, dated March 21, 2022

B. Risks, Vulnerabilities and Challenges

Figure 11. Country Risk Map: Vietnam



Source: AMRO staff

B.1 Near-term Risks to the Macro Outlook

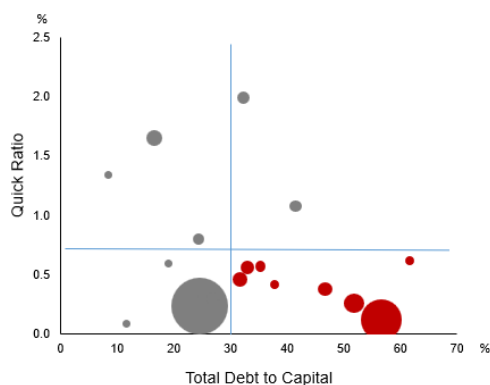
15. Risks to the growth outlook are tilted towards the downside. The main downside risk stems from key export markets—particularly potentially weaker-than-expected consumer demand in the U.S., a sharp growth slowdown in Europe, and a slower growth in China. The ongoing robust recovery in Vietnam's exports and, thus, manufacturing production, will be weakened, if the U.S. economy, especially household consumption, is weaker than expected. Moreover, the export outlook remains uncertain, largely influenced by trade policy of the incoming Trump administration. During the first Trump administration, Vietnam saw a significant rise in FDI as companies relocated from China to avoid the tariffs. Looking ahead, the potential escalation of U.S.-China tensions could attract more FDI into Vietnam, that would boost Vietnam's exports to the U.S. market. However, U.S. trade protectionist measures against its partners could negatively impact the Vietnamese economy, given its critical role in global supply chains and as a manufacturing hub for many multinational corporations.

16. A potential rise in consumer price inflation could delay the recovery of domestic demand. While inflation is currently well-contained, there are risks of acceleration driven by supply-side factors. The likelihood of a spike in global oil prices persists given the fragile geopolitical situation in the Middle East. Shipping costs could also increase if the ongoing conflict in the Middle East deepens. Separately, more extreme weather conditions caused by El Niño and La Niña could dampen crop production and push up food prices. Despite such upside risks to consumer prices, headline inflation would likely remain below the government's target ceiling of 4.5 percent.

17. Housing market prospects could be clouded by delays in the implementation of the new real estate laws and tight financing conditions faced by property developers. The financial positions of real estate developers have deteriorated, with the interest coverage

ratio declining steadily to 0.7 by the end of Q2 2024, down from 1.8 at the end of 2022.²⁸ Several large developers face liquidity difficulties with quick ratios below 1,²⁹ and are highly leveraged, with debt-to-equity ratios for some developers exceeding 60 percent (Figure 11). Meanwhile, development projects have been halted due to outdated and inconsistent regulations, leading to a shortage of new supplies. Subordinate regulations of the new real estate laws are still being drafted—the slow drafting and implementation of the laws could continue to dampen developers’ revenue. Additionally, tepid investor confidence in the corporate bond market and banks’ more cautious lending practices have made it more challenging for developers to refinance and secure funding. With a substantial amount of corporate bonds issued by developers maturing in 2024 and 2025, default risks among property developers, particularly those that are highly leveraged, remain elevated.

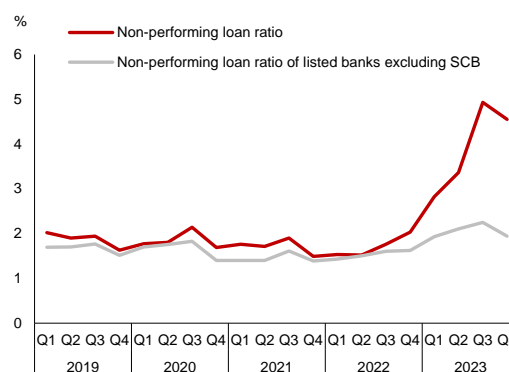
Figure 12. Leverage and Liquidity of Property Developers (2024)



Source: Bloomberg; AMRO staff calculations

Note: The quick ratio measures a company’s ability to meet its short-term obligations with its most liquid assets. It is measured as the ratio of current assets minus inventories to current liabilities. The higher the ratio, the better the company’s liquidity position. A quick ratio lower than 1 mean the company is relying heavily on inventory or other assets to pay its short-term liabilities. The bubble size represents the relative asset size of a developer to the total sample assets. The vertical and horizontal lines represent the sample average. Data are as of Q1 2024.

Figure 13. Bank Sector’s NPL Ratio



Source: SBV; CEIC; FiinPro; AMRO staff calculations

Note: SCB stands for Saigon Commercial Bank

18. Despite the ongoing economic recovery, asset quality in the banking system continues to deteriorate. Bad debt has already increased amid weak economic conditions and housing market challenges (Figure 12). The loan moratorium program³⁰ freezes borrowers’ loan classifications and allows them to defer principal repayments on existing loans, while enabling them to secure new credit from banks. In addition, as of July 2024, lending to the real estate sector accounts for 21 percent of banks’ total outstanding loans, of which lending to real estate developers accounts for about 8 percent.³¹ NPLs could increase further, if more property developers become financially distressed. The amended Law on Credit Institutions³², approved in January 2024, enhances the legislative power of the bad debt management mechanism by incorporating Resolution 42/2017/NQ-QH14³³. However, the revised law omits certain provisions from Resolution 42, such as the right to seize collaterals. This could pose challenges for financial institutions in effectively managing collateral and bad debts.

²⁸ The indicator is calculated based on listed companies.

²⁹ The quick ratio is an indicator of a company’s short-term liquidity and measures a company’s ability to meet its short-term obligations with its most liquid assets. The higher the ratio, the better the company’s liquidity position. A quick ratio lower than one can mean that the company is relying heavily on inventory or other assets to pay its short-term liabilities.

³⁰ Circular 06/2024/TT-NHNN introduced on June 18, 2024, revises and supplements Circular 02/2023/TT-NHNN, in which the SBV allows a six-month extension of Circular 02 until the end of 2024, instead of expiring on June 30, 2024.

³¹ As of July 31, 2024, NPL ratio associated with the real estate sector reached 3.4 percent, compared to 2.6 percent at the end of 2023.

³² The Law on Credit Institutions 2024 (No. 32/2024/QH15)

³³ The resolution piloted a program to handle legacy bad debt of Vietnamese credit institutions.

B.2 Longer-term Challenges and Vulnerabilities

19. The government continues to face challenges stemming from substantial carry-over expenditures, especially in capital expenditures.³⁴ The execution rate of total expenditure was approximately 75-80 percent of the plan in 2022-2023 while current expenditure execution was around at 85-90 percent, and capital expenditure execution was lower at 60-65 percent.³⁵ The sluggish pace of public investment disbursement is primarily due to delays in land acquisition and clearance, inconsistencies in regulations, lengthy and complex administrative procedures, and limited planning capacity. In addition, different interpretations of the laws by executing agencies and the state auditor have prolonged decision-making processes within these agencies, leading to delays in budget disbursement. The delay in government budget execution has hampered the government's ability to swiftly respond to a cyclical economic slowdown and has led to inefficiencies in resource allocation, as a significant portion of untapped budget remains idle as cash in the State Treasury. As of the end of H1 2024, the accumulated cash position reached VND1,000 trillion, equivalent to 9 percent of GDP. The main problem with a low execution rate of fiscal allocation and a large carry-over is that it results in difficulties in fiscal planning and reduces the effectiveness of fiscal policy implementation. (Selected Issue 2. The Challenges of Carry-Over Expenditures in Vietnam's Fiscal Management)

20. Infrastructure bottlenecks and a shortage of skilled labor can impede a country's long-term growth potential. Vietnam's rapid growth over the past decades has not been accompanied by sufficient infrastructure development, in particular transportation and power generation. Poor connectivity between seaports, airports, warehouses, and industrial parks increased logistics costs to approximately 17 percent of GDP in 2023, higher than the global average of 10.6 percent (Ministry of Industry and Trade 2023). Insufficient power supply not only hampers domestic economic activity but also diminishes the country's attractiveness to foreign investors. Another major challenge facing Vietnam is a mismatch between workforce skills and industry requirements, with many foreign firms struggling to hire mid-level engineering and managerial staff. The education and training system has yet to equip the workforce with the necessary skills and knowledge to meet the demands of a rapidly evolving economy.

21. The under-development of domestic supporting industries has impeded the country's progress in moving up the global value chains. Vietnam has successfully achieved high growth over the past decade, but much of its success can be attributed to MNCs, which for the most part rely on the country's low-cost labor to assemble final products for export. The purported merits of MNC activities in areas such as technology transfer have not quite borne out, largely due to the inability of local firms – mostly SMEs – to produce higher value-added intermediate products of sufficiently high quality to meet the demands of MNCs. Vietnamese SMEs still face difficulties in securing capital and financing for scaling up production due to the lack of adequate collateral, transparent and standardized financial statements, and long-term business strategy. For SMEs involved in exports and imports, the use of trade finance is relatively limited and mainly involves basic instruments, such as letters of credit and working capital loans. (Selected Issue 3. Trade Finance in Vietnam: Supporting Growth for MSMEs)

22. The increasing frequency and intensity of global warming induced weather conditions have caused major damages and disruptions to Vietnam's economic

³⁴ The government's expenditure disbursement was only 59.3 percent of the budget until September 2024, while the disbursement rate of recurrent and capital expenditure reached 68.0 percent and 47.3 percent of the budget respectively.

³⁵ AMRO staff's estimate

activity. Vietnam's geographical uniqueness and the concentration of economic activities along a long and densely populated coastline, make the country highly vulnerable to climate change.³⁶ The country has also witnessed a marked increase in greenhouse gas (GHG) emissions over the past two decades. Electricity demand and GHG emissions have grown more than fivefold over the period and will continue to increase in the next few decades in line with rapid industrialization and urbanization if no actions are undertaken. Meanwhile, extreme weather conditions have caused mounting losses for the economy, particularly in the agriculture sector. Data from the General Department of Disaster Prevention and Control show that economic losses caused by extreme weather events doubled from VND 68.2 trillion (0.3 percent of GDP) during 2011-2016 to VND 161.7 trillion (0.5 percent of GDP) during 2016-2020.

23. A rapidly aging population will pose challenges to the Vietnamese economy in the next decade. By the year 2036, Vietnam is projected to transit from an aging society to an aged society due to an increase in life expectancy³⁷ and a sharp decline in fertility rate³⁸. The old age dependency ratio³⁹ would increase from 14.7 percent in 2024 to 21 percent in 2036. A rapidly aging population presents Vietnam with significant economic challenges, including a shrinking working-age population, reduced opportunities for business expansion, increasing old-age poverty, and inadequate social protection for the elderly. A rapidly aging population also raises fiscal concerns about reduced tax collection and increased government spending on healthcare. Public pension funds are likely to face deficits as the number of pension contributors would decline while pension payments would increase exponentially due to longer life expectancies. AMRO's simulations indicate that the ongoing pension fund reforms will only delay the social insurance fund's deficit till 2035.⁴⁰ Moreover, the social insurance fund's current investment schemes, which concentrate on Vietnam's treasury bonds or bonds issued by local public agencies, have yielded declining returns, thus suppressing the fund's net revenue. (Selected Issue 4. Ensuring the Sustainability of Vietnam's Public Pension Fund through Asset Diversification)

24. Cyber threats have become more complex, necessitating more advanced cyber risk management systems along with robust cybersecurity policies and regulations. Although the Vietnamese government has strengthened the cyber security framework, the number of cyberattacks has continued to increase. According to Vietnam National Cyber Security Technology Company, the country saw approximately 13,900 cyberattacks in 2023, up by 9.5 percent yoy, causing losses of more than VND390 trillion (equivalent to 3.6 percent of GDP). The total losses to online scammers reached VND 10 trillion, 1.5 times higher than in 2022, with approximately 91 percent of the losses linked to financial services. In 2024, there have already been three large-scale data encryption attacks so far, targeted at three large companies in the financial, petrochemical, and telecommunication sectors.

³⁶ According to USAID (November 2022), Vietnam is one of the world's top five most vulnerable countries to climate change, especially typhoons, droughts, and landslides along its coastline. The government continues to strengthen the early forecasting/warning system, forest infrastructure and dams to minimize damages by physical climate risks.

³⁷ According to the United Nations, the life expectancy of Vietnamese people increased from 69.2 years in 1990 to 74.5 years in 2022.

³⁸ According to the United Nations, Vietnam's fertility rate declined from 3.6 births per woman in 1990 to 1.9 births per woman in 2022. As for other ASEAN countries, the numbers declined as follows: Singapore, from 1.8 in 1990 to 1.0 in 2022; Thailand, from 2.1 in 1990 to 1.3 in 2022; Malaysia, from 3.4 in 1990 to 1.8 in 2022; Indonesia, from 3.1 in 1990 to 2.2 in 2022; and the Philippines, from 4.4 in 1990 to 2.7 in 2022.

³⁹ The old-age dependency ratio is defined as the number of people aged 65 and above divided by the number of people of working age between 15 and 64 years old.

⁴⁰ Due to data limitations, this exercise cannot account for the impacts of ongoing lump-sum withdrawals before the Amended Law on Social Insurance takes effect in 2025. These withdrawals could further reduce the net revenue estimated by this simulation.

C. Policy Discussions and Recommendations

C.1 Active Role of Fiscal Policy in Broadening Economic Recovery

25. Amid an uneven economic recovery, the government should recalibrate the fiscal support measures to target MSMEs and low-income households and increase capital spending. Vietnam's ample fiscal space⁴¹ allows the government to extend additional support to vulnerable segments, such as offering training programs, reducing tax rates for MSMEs⁴², improving social assistance programs, and employing credit guarantee schemes. To mitigate potential revenue losses due to tax rates cuts on MSMEs, the government should phase out tax deferrals and the 2-percent VAT reduction once a recovery of domestic economic activity well entrenches. Given the challenges the government had faced in implementing targeted measures in a timely manner in the past, it could consider developing an integrated database to monitor and assess the economic conditions of disadvantaged groups, ensuring they receive timely support from the state budget.⁴³ Furthermore, the government should expand infrastructure development to address bottlenecks. Greater discretion and authority is being devolved to local governments in executing public investment projects⁴⁴. However, to ensure accountability, the government must also enhance its inspection and oversight mechanisms to monitor the performance of decentralized and delegated responsibilities effectively. Allocating sufficient spendings on healthcare, education and training, as well as poverty reduction, are essential in boosting the country's growth potential and making growth more inclusive.

26. The government should further strengthen state revenue management. The authorities have employed digital technologies, such as the implementation of electronic invoices and the tax collection on e-commerce platforms, to strengthen and modernize revenue collection, leading to an increase in fiscal revenue. Nevertheless, it is critical to enhance the enforcement of tax laws and encourage private sector compliance, to minimize tax fraud and evasion.⁴⁵ Furthermore, the government should also enforce stringent measures to address tax arrears, including revoking business licenses, imposing late payment penalties, and freezing business accounts at commercial banks⁴⁶. In addition, the government should continue restructuring fiscal revenues by simplifying the tax system,⁴⁷ broadening the revenue

⁴¹ Vietnam has ample fiscal space, based on AMRO's fiscal space framework. To finance the deficit, the debt-to-GDP ratio and gross financing need-to-GDP ratio are projected to stay significantly below the benchmark, despite any potential shocks that may arise in the medium term. Although external debt accounts for around 30 percent of public debt, not including publicly guaranteed debt, the majority consists of concessional or semi-concessional loans.

⁴² From 2013- 2015, MSMEs benefitted lower CIT rate of 20 percent, compared to normal CIT rate of 22-25 percent. However, from 2016 and onward, MSMEs pay the same rate as large enterprises (20 percent) as stipulated in the CIT Law enacted in 2016, despite there is another law (Law on MSMEs enacted in 2017) which stipulated that MSMEs are entitled to a lower CIT rate. Aligned with the government's plans to amend the CIT law, it is essential to consider reducing the CIT rate for MSMEs to ensure consistency with the Law on MSME Support.

⁴³ At present, each government agency maintains a separate database for its specific programs, resulting in fragmented and non-shared data across agencies. The integration of these databases can be facilitated by using a single national identification number for individuals or businesses, enabling interoperability among systems. A unified, integrated database that offers timely access to all relevant data can significantly enhance government decision-making, increase transparency, and improve the delivery of public services.

⁴⁴ According to the Government Resolution No.04/NQ-CP dated January 10, 2022, the government is mandated to revise the decentralization of decision-making authority for investment policies from the Prime Minister or central government to the local government. Nevertheless, the regulation outlining the mechanisms of this new framework has yet to be finalized.

⁴⁵ The Ministry of Finance estimated revenue losses from tax evasion and fraud to be around VND8.7 trillion in the first half of 2024.

⁴⁶As a social punishment, the government could also publish the list of businesses with overdue tax liabilities and significant tax debts. Furthermore, the government should enhance collaboration among relevant agencies to access data and information necessary for assessing tax obligations.

⁴⁷ Currently, international trade is subject to a variety of taxes according to Vietnam's tax administration, such as export tax, import tariffs, excise tax, VAT, and environmental tax. Each of this type of taxes have multiple tariff rates. Simplifying or reducing the number of these tariff rates could stimulate greater international trade activity. Additionally, under the current VAT Law, there are three type of tariff rates that can be applied to goods and services: 0 percent, 5 percent, and 10 percent. As stipulated in the Prime Minister's Decision No. 508/QĐ-TTg, dated April 23, 2022, the government aims to implement a unified VAT rate by 2030.

base through new sources⁴⁸, and eliminating tax exemptions⁴⁹ that no longer support socio-economic development goals.

27. The government should address structural impediments causing the slow disbursement of budgeted expenditure, particularly capital expenditures. The lack of consistency and clarity in the laws pertaining to public investment, which leads to slow disbursement, should be removed. The timely implementation of the new land laws and its relevant decrees, particularly the land valuation method, would help expedite land acquisition and site clearance. The government may consider shortening the timeframe for budget allocation and ensure that the executing agencies (both central and local governments) promptly implement the projects, once the National Assembly approves the budget⁵⁰. Moreover, improving the procurement process can help ensure that allocated funds are utilized within the fiscal year. It is also essential to ensure that the faster disbursement of the budget is commensurate with implementation capacity to enhance the effectiveness of public funds. Strengthening public investment management institutions is crucial to avoid inefficient resource utilization and delays in the project completion.

28. Reducing the time for the settlement of accounts and minimizing carry-over expenditures is important. In any year, the budget preparation for the following year—which involves, inter alia, formulating appropriate policy responses to economic conditions—is often challenging, due to a delay in the closure of the previous year’s accounts and a lack of accurate disbursement schedule, including carry-over expenditures. According to the Budget law, the final data are only released 18 months after the end of the fiscal year. This long process is partly due to complex and multilayered administration. Although the Ministry of Finance announces estimates of fiscal operation for the year in September in order to prepare for the following year’s budget, these announcements do not include the disbursement of carry-over expenditures from the previous year. Additionally, the persistent carry-over expenditures, coupled with coverage gaps in recording liabilities and assets, have resulted in significant discrepancies between above- and below-the-line fiscal data.⁵¹ This discrepancy underscores the need for improved harmonization in fiscal reporting, to ensure consistency and transparency. The timeline to finalize the settlement of fiscal accounts should be shortened, and the amount of carry-over expenditure minimized. Unutilized funds not only hinder the ability to obtain an accurate picture of government spending for each fiscal year, but also pose challenges for public debt management and cash management within the state treasury system.

Authorities’ views

29. Despite the economic disruption caused by Typhoon Yagi, the Vietnamese government remains committed to achieving GDP growth of 6.8-7.0 percent in 2024. Efforts are currently underway to repair the damage and restore economic activity in affected

⁴⁸ The authorities could introduce new taxes to expand the tax base, such as the property tax and excise tax on sugar sweetened beverages. Enacting a property tax law could promote a healthier real estate market by reducing speculative investments in real estate. The introduction of a new excise tax on sugar sweetened beverages not only can expand tax base but also protect public health.

⁴⁹ Despite the new VAT Law has been issued in November 2024, a wide range of goods and services remain exempt from VAT, including salt products, gold bars, medical services, financial and banking services. The authorities should consider reducing the number of goods and services exempt from VAT by applying the 5-percent rate to these items.

⁵⁰ According to the Budget Law, the National Assembly is required to approve the following year’s budget plan by November 15. Subsequently, by November 20, the Prime Minister must announce the estimates revenue and expenditure of each central government institution (ministries and agencies) and provincial governments based on the approved budget from the National Assembly. Then, both central and local governments are obligated to allocate the more detailed budget allocations for each program/project and their subordinates to align with the Prime Minister’s decision, no later than December 31. However, some ministries and localities are often not completed their detailed budget allocations even after the fiscal year has commenced.

⁵¹ For further explanations, please refer to International Monetary Fund (2024). *Vietnam: 2024 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Vietnam*. IMF Staff Country Reports 2024. <https://doi.org/10.5089/9798400290404.002>

areas. However, inflation continues to be a concern, as monetary easing in many countries could drive up global inflation, including in Vietnam.

30. The government recognizes the importance of public infrastructure investment in supporting growth and aims to reduce logistics costs from the current 16-17 percent of GDP to 11-12 percent. Plans for new deep-sea ports, airport terminals, highways, and railways are already being made. However, disbursement of funds for these infrastructure projects remains challenging due to administrative complexities and lengthy land clearance procedures.

C.2 Employing Accommodative Monetary Policy to Support Domestic Demand

31. To the extent that inflation is well anchored and has been brought under control, the monetary policy stance can remain accommodative to support more broad-based recovery. While output gap has turned positive in 2024, thanks to strong export performance, economic recovery still has not been broad-based. Domestic demand remains sluggish, and MSMEs continue to face challenges. The acceleration of consumer price inflation in the first half of 2024 was primarily driven by supply-side factors and exchange rate depreciation while demand-side pressure was soft. Looking ahead, inflation is expected to remain below the government's target ceiling of 4.5 percent. On the external front, the Fed's recent rate cut has lessened pressure on the Vietnamese dong and reduce the risk of speculative capital outflows reflecting the narrower interest rate differential between the U.S. and Vietnam. In this regard, the authorities should maintain the current accommodative monetary conditions to stimulate domestic demand.

32. While interest rates should be kept low enough to ensure accommodative financial conditions, the indicative credit growth target may need to be reconsidered. Low interest rates would alleviate the financial burden on MSMEs and heavily indebted households, thereby boosting economic activity. However, the current indicative annual credit growth target of 15 percent may be too high, given the low level of credit demand. It could result in excess liquidity that needs to be mopped up and potentially interfering with the maintenance of exchange rate stability. The indicative credit growth target should be determined based on the development of real economic growth and inflation conditions. While the loan moratorium program has alleviated the debt service burden, these measures should expire as scheduled, to prevent borrowers who are not creditworthy from accumulating more debt, and to avoid unintentionally propping up nonviable firms.

33. Modernizing the monetary policy framework will strengthen the role of monetary policy in containing inflation. The mission commends the SBV's ongoing efforts to liberalize interest rates and modernize the monetary policy framework. In the first half of 2024, the SBV actively utilized OMOs in the interbank market to reduce the interest rate differential between Vietnam and the U.S., in order to curb the depreciation of the VND. Looking ahead, in pursuit of deepening financial market developments in support of the country's rapid economic growth, continuing efforts should be made to reform the monetary policy framework by phasing out the use of quantitative credit targets and moving toward a market-based interest rate approach. Maintaining consumer price inflation below the target inflation ceiling and anchoring inflation expectations should be the SBV's primary focus, while continuing to enhance exchange rate flexibility as a buffer against external shocks. Over the past decade, the SBV's communications with stakeholders have made significant progress. Going forward, providing regular reports and briefings to the markets on the economic outlook and policy direction will help anchor public expectations, promote the central bank's independence and accountability, and enhance its credibility.

Authorities' views

34. The SBV has forecasted GDP growth of 6.5-7 percent for 2024, after accounting for the impact of Typhoon Yagi. In the first half of the year, economic growth stood at 6.4 percent. Historically, growth in the second half tends to exceed that of the first, thanks to the government's capital expenditure. A relatively strong performance in the third quarter of this year is expected to strengthen growth for the remainder of the year. However, the economic impacts of the typhoon may become more evident in the final quarter.

35. The recent monetary policy stance has been accommodative, as shown by declining deposit and lending rates. The recent increase in the overnight interbank lending rate reflects a tight liquidity condition rather than tight monetary conditions. Going forward, the monetary policy stance should be conditional on inflationary pressure and exchange rate volatility.

36. The SBV opines that there is no need for the revision of the current indicative credit growth target. The indicative credit growth is determined in harmony with macroeconomic developments to contribute to supporting economic growth, controlling inflation, stabilizing the macro economy, and ensuring the safety of credit institutions' operations. The government designated the indicative credit growth target in 2024 at 15 percent, with appropriate adjustments to actual developments and situations; and researching and innovating credit growth management.

C.3 Safeguarding Financial Stability

37. Commercial banks' capital and liquidity buffers should be strengthened to safeguard the financial sector against rising credit and liquidity risks. To create stronger safeguards against future shocks, and in view of the expiry of the loan restructuring program, capital and liquidity buffers can be further strengthened. While the banking system is moving toward the full implementation of Basel II standards, the introduction of higher quality capital, such as a tier-1 CAR⁵² and additional capital requirements on domestic systemically important banks should be considered. Specifically, SOCBs should focus on increasing provisions, capital buffers and liquid assets. Banks should consider raising capital by retaining profits or raising equity in the market. In addition to the total LTD ratio, non-financial institutions and foreign currency LTD ratios should also be monitored to contain liquidity risk.

38. Strengthening capital buffers and improving the bad debt management framework will help safeguard banks against deteriorating loan quality. Commercial banks should focus on increasing provisions, capital buffers, and liquid assets. Additional capital requirements should be imposed on domestic systemically important banks (DSIBs). The introduction of higher-quality capital, such as Tier-1 CAR, should be considered. Legal processes should be streamlined to improve bad debt recovery processes, such as adopting fast-track court procedures, reducing bureaucratic delays, enhancing transparency of asset registration and valuations, and promoting arbitration and mediation services to resolve disputes between banks and borrowers. In addition, the government should consider reforming the insolvency framework and relevant legal procedures to facilitate creditors to seize collateral assets for bad debt recovery.

39. The banking resolution framework should be strengthened further to ensure the timely and orderly resolution of troubled banks. The revised credit institution law, approved in January 2024, allows the SBV to make early interventions and provide emergency

⁵² Vietnam could work toward the 2022 average 17.9 percent tier-1 CAR of emerging market and lower-income developing economies in ASEAN, comprising Cambodia, Indonesia, the Philippines and Thailand. The tier-1 CAR of Vietnam was about 9.6 percent in 2022.

liquidity to a troubled bank. The new law stipulates the conditions for early intervention and measures to be applied. The law also outlines measures for the restructuring of credit institutions. However, the framework for banking resolution needs to be strengthened, particularly in defining the conditions for resolving insolvent banks, clarifying mandates and responsibilities of supervisory agencies and relevant authorities, providing guidelines on resolution tools, and conducting annual test-runs of recovery plans, particularly for DSIBs. Furthermore, the banking resolution framework should be designed carefully to mitigate moral hazard problems by setting rules that require shareholders to bear losses and tightening regulatory supervision and inspections. Given that the ongoing acquisitions of several weak banks, known as ‘zero-dong banks’, have been underway, the mergers and acquisitions process should be expedited to eliminate inefficiencies in the banking system and benefit from economies of scale, in addition to improving internal risk controls and corporate governance.

40. Banking sector governance is expected to improve gradually following a new law becoming effective on July 1, 2024. The Law on Credit Institutions 2024 (No. 32/2024/QH15) aims to enhance bank transparency and reduce cross-ownership between banks and non-financial corporations. It broadens the definition of related parties, reduces bank ownership limits for institutional and related party bloc shareholders, and enhances banks’ information disclosure requirements pertaining to ownership. The law also introduces lending caps for groups of related party customers. While implementation and compliance of these new banking regulations may prove challenging as ownership can still be hidden through proxies and shell companies, they signal a strong commitment by regulators to address long-standing structural governance weakness in the sector. Increased inter-agency coordination, particularly through data sharing, would enhance the law’s efficacy. (Box A. Corporate Governance in Vietnam’s Banking Sector)

Box A. Corporate Governance in Vietnam’s Banking Sector⁵³

Three key regulations in the past decade guided the evolution of corporate governance standards in Vietnam’s banking sector. The Law on Credit Institutions (No. 47/2010/QH12) specified the structure and responsibilities of the board of directors and supervisory board, required the establishment of internal control systems and audit, and mandated share ownership and lending limits. Circular 36/2014/TT-NHNN contained stipulations that addressed a then-standing governance issue; cross-ownership between banks (Nguyen and Trinh 2024). Circular 13/2018/TT-NHNN, which was pivotal towards Basel II adoption, issued updated regulations pertaining to governance duties of the board of directors, supervisory board and senior management, established detailed guidelines for internal control systems to identify, control, mitigate and report risks, as well as the development of internal risk management policies, internal auditing and compliance.

The Law on Credit Institutions 2024 (No. 32/2024/QH15), which became effective July 2024, tightens regulations relating to ownership of banks. The law broadened existing definitions of related parties to include sub-subsidiaries, and family members such as children (adopted, step, in-law), in-laws (brothers, sisters, and their spouses), paternal and maternal grandparents, grandchildren, and biological aunts and uncles. The law also lowers ownership limits of banks, reducing institutional shareholders limits from 15 percent to 10 percent, related persons shareholder blocs from 20 percent to 15 percent, and caps individual ownership to 5%. It also gradually reduces the credit limit banks can extend to a single borrower (group of related party borrowers) from 15 percent to 10 percent (25 percent to 15 percent) by January 1, 2029. Lastly, shareholders with 1 percent ownership or more (down from 5 percent) must publicly disclose information on their, and their related parties’ bank ownership.

⁵³ Prepare by Wen Yan (Ivan) Lim, Associate Economist.

This follows a high-profile fraud case at a major bank. The Chairwoman of a prominent conglomerate was found guilty in April 2024 of embezzlement and fraud. From 2012 to 2022, tens of billions of US dollars (amounting to more than 90 percent of the bank's total loans) were siphoned from the bank in the form of fraudulent loans to her network of more than 1000 shell companies, subsidiaries, and affiliates. She was able to do so as she effectively controlled the bank, despite regulatory ownership limits, commanding more than 90 percent of ownership shares through hundreds of shell companies and proxies. Through her ownership, the accused was able to appoint figureheads to key positions at the bank, violating regulations relating to banking operations, loan limits, internal controls, compliance, and corporate governance, in order to disburse the bank's funds. Prompt actions by the SBV to provide liquidity support and place the bank under special control helped stem deposit runs on the bank, prevented contagion and maintained banking sector stability.

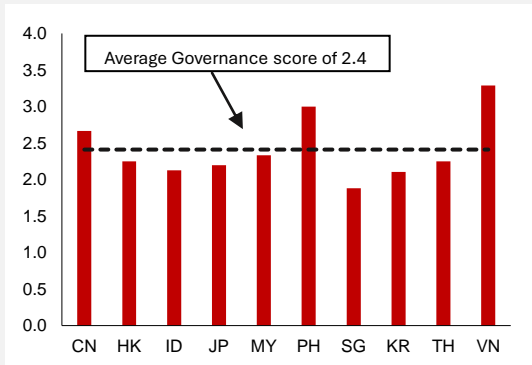
While The Law on Credit Institutions 2024 (No. 32/2024/QH15) attempts to address the risks of cross-ownership between banks and non-financial entities, it may run into implementation and conceptual challenges. It aims to reduce the undue influence that large shareholders might have on the bank's operation and undermine corporate governance regulations that are already in place. However, despite tightened regulations, ownership could still be hidden through proxies and affiliates. Further, it may also limit the potential through which large blockholders can improve corporate governance by reducing agency problems that arise from the separation of ownership and control (Edmans 2014). Foreign institutional investors may also have less incentives to impart governance best practices to local banks (Aggarwal and others 2011). The reduction of lending limits might also disproportionately affect foreign bank branches' lending due to their smaller capital size, forcing them to scale down on lending to key clients, barring the raising of additional capital.

While these reforms are a major step forward, more can be done to improve the efficacy of the law and overall banking sector governance. Corporate governance of banks in Vietnam are still the lowest in the region (Figure A.1), with small Joint-stock Commercial Banks (JSCBs) having the lowest scores compared to mid-sized JSCBs and large State-owned Commercial Banks (Figure A.2).⁵⁴ To enhance the efficacy of the amended law, enhanced inter-agency cooperation to overcome legal mandates and the sharing of data and resources would be essential in unearthing hidden ownerships during the supervisory process. More broadly, as the effectiveness of one governance dimension may be conditioned on another, it is important not to assess each mechanism in isolation (De Haan and Vlahu 2016). To that end, the continued refinement and alignment of the suite of governance regulations to international best practices (such as Basel's Corporate Governance Principles for banks) emphasizing the roles and responsibilities of the board, risk management, compliance, internal control processes, and enhanced disclosure and transparency, would strengthen overall governance standards in the sector and promote financial stability.⁵⁵

⁵⁴ Moody's ESG ratings are derived using both quantitative and qualitative judgement, with the governance "G" rating constituting five broad categories (Financial Strategy & Risk Management; Management Credibility & Track Record; Organizational Structure; Compliance & Reporting, and; Board Structure, Policies & Procedures). Each bank is given a rating from 1-5, with 1 being the "best", and 5 being the "worst". The Moody's sample includes 216 banks for the ASEAN+3 region and are mainly the larger more systematically important banks. There are 21 banks in Vietnam (10 small-sized JSCBs, 7 mid-sized JSCBs, and 4 large SOCBs). Size ratings are defined following (Selected Issue 1), with medium-sized (small-sized) JSCBs designated as banks whose asset share is between 3%-9% (less than 3%) of total system's assets. Simple averages are used to calculate country-level, and bank-type governance scores.

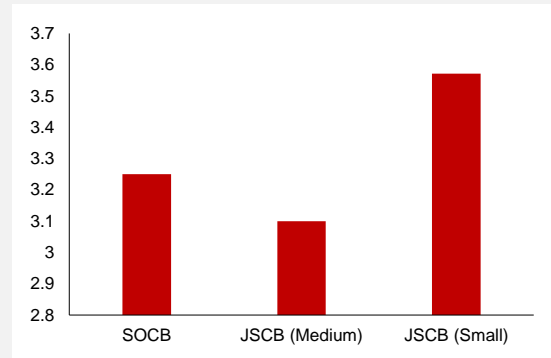
⁵⁵ <https://www.bis.org/bcbs/publ/d328.htm>

Figure A1. Selected ASEAN+3: Average Bank Governance Scores



Source: Moody's CreditView; AMRO staff calculation
Note: The sample includes 216 banks. Each bank is given a Moody's "Governance" rating from 1-5, with 1 being the "best", and 5 being the "worst". Country scores are calculated using simple averages. CN = China; HK = Hong Kong; ID = Indonesia; JP = Japan, MY = Malaysia; PH = Philippines; SG = Singapore; KR = Korea; TH = Thailand; VN = Vietnam.

Figure A2. Vietnam: Average Bank Governance Scores by Bank Type



Source: Moody's CreditView; AMRO staff calculation
Note: The sample includes 21 banks (10 small-sized JSCBs, 7 mid-sized JSCBs, and 4 large SOCBs). JSCBs whose asset share is between 3%-9% (less than 3%) of total system's assets are classified as medium (small) sized. Each bank is given a Moody's "Governance" rating from 1-5, with 1 being the "best", and 5 being the "worst". Bank type averages are calculated using simple averages.

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41. Additional measures should be taken to ease real estate developers' financial distress and to strengthen the governance in the sector. AMRO welcomes the government's efforts to address the problems faced by real estate developers. The amended laws and a series of new measures and regulations adopted in 2023 and early 2024, are expected to address legal bottlenecks and boost market confidence. Nonetheless, additional actions could still be considered.

- The funding sources of property developers should be diversified by accessing the equity and corporate bond market, forming mergers and alliances with other developers, and selling real estate assets or land so that they can reduce their reliance on bank loans.
- A macroprudential policy framework should be put in place to curb speculative demand and address imbalances in the housing market, including statutory loan-to-value ratios and debt service-to-income ratios. Supervision must be strengthened to ensure that commercial banks adopt prudent lending practices toward property developers, such as imposing loan concentration limits.
- To support viable developers with immediate financial needs and liquidity problems, financing should be provided to sound projects by improving standards for evaluating their viability, encouraging banks to introduce an escrow account to avoid misuse of project funds and establish a loan guarantee scheme. Banks are encouraged to collaborate with viable developers to assess challenges, including the liquidity conditions of real estate development projects, and develop appropriate solutions in compliance with domestic laws and regulations, while ensuring the stability of the banking system.

42. Coordination among ministries and government agencies is required to successfully implement the amended laws and to facilitate the recovery of the property

market. The early enforcement of the three important laws⁵⁶—the Land Law, the Real Estate Business Law, and the Housing Law—would help address legal bottlenecks (Box B. Vietnam’s Laws on the Real Estate Sector: Key Amendments).⁵⁷ Furthermore, it is imperative to harmonize laws, regulations, and administrative procedures across all government agencies to ensure the clarity, transparency, and consistency of the legal framework. To improve the attractiveness of the social housing loan packages, the SBV and the Ministry of Construction (MOC) could consider revising the interest rates to make the packages more affordable. Lastly, while the MOC has made progress in developing the real estate database, there is a need to standardize and centralize data on real estate transactions across various government agencies as well as to develop property price indices. The SBV could consider developing property price indices based on the data on bank transactions related to real estate.

Box B. Vietnam’s Laws on the Real Estate Sector: Key Amendments⁵⁸

Vietnam’s National Assembly passed amendments to three laws, including the law on housing, the law on real estate business in November 2023, and the law on land in January 2024. These laws, which came into effect on August 1, 2024, are expected to have positive impacts on the real estate market by addressing legal bottlenecks, providing more protections for buyers, granting more opportunities for people to own social housing, and preventing speculation.

Law on Land

The Land Law 2024 introduces significant amendments to land valuation, land acquisition and compensation, and land resource management (Table B1). These amendments aim at having more market-based land valuation, enhancing fair compensation, and protecting the rights of individuals and communities. While these changes offer several benefits such as improved transparency and land use optimization, they also present challenges such as increased costs for developers and the need for efficient administrative processes. Furthermore, it will take time for associated decrees, regulations, and guidelines to become fully effective in practice, particularly the ones on land valuation.

Table B1. Key Amendments in Law on Land

Law on Land: Key Amendments	Impacts and Challenges
<ul style="list-style-type: none"> ● Land Valuation: <ul style="list-style-type: none"> ▪ The law abolishes the land price bracket. ▪ Land price list will be announced on an annual basis. ▪ Land valuation can be based on four methods: (1) Comparison method; (2) Residual method; (3) Income method; (4) Land price adjustment coefficient method (Decree 12/2024/ND-CP). These methods can reflect real market conditions by considering various factors such as comparable land sales, income potential from the land, and market adjustments. 	<ul style="list-style-type: none"> ● Market-aligned Compensation: Announcing land price lists on an annual basis and applying market-based land valuation methods are expected to make compensation more aligned with market prices, facilitating the land clearance and acquisition process. ● Increased Costs for Developers: Developers may face higher clearance costs that will, in turn, be passed to the buyers.

⁵⁶ The amended laws will come into effect on August 1, 2024, five months ahead of the originally approved date of January 1, 2025.

⁵⁷ The lingering legal bottlenecks that the law amendment should address are land valuation and ownership, land conversion, compensation, resettlement, information disclosure of real estate businesses, and the management of social housing.

⁵⁸ Prepared by Trung Thanh Vu, Associate Economist.

<ul style="list-style-type: none"> ● Land Recovery, Land Acquisition, and Compensation: <ul style="list-style-type: none"> ▪ The law specifies 32 cases in which the State can recover land for socio-economic development, including infrastructure projects. The land acquisition process involves several steps designed to ensure transparency and fairness, such as public notification of land use planning, specification of land acquisition purposes, public consultation, compensation, and resettlement arrangements. ● Resettlement Arrangement: <ul style="list-style-type: none"> ▪ Resettlement areas must have infrastructure (such as roads and utilities) that match detailed planning approved by the authority. ▪ Approval of compensation, support, resettlement plans, and resettlement arrangements must be completed before the land recovery decision is made. 	<ul style="list-style-type: none"> ● Clarity and Transparency: The clear specification of land recovery cases provides clarity and transparency to landowners and developers, reducing uncertainty in the market and preventing unjustified land recovery and acquisitions, which may cause disputes and public concerns. ● Protection for Individuals and Communities: The amendments aim to protect individuals and communities during the land acquisition process, reducing conflicts and ensuring developers comply with relevant laws and regulations.
<ul style="list-style-type: none"> ● Managing and Developing Land Resources: <ul style="list-style-type: none"> ▪ The new law introduces Chapter VIII for the development, management, and exploitation of land funds—a term referring to designated land resources that the government allocates and manages for development purposes. ● Transfer of Land Use Rights: Individuals are allowed to receive more agricultural land use rights. ● Other Amendments: <ul style="list-style-type: none"> ▪ Dispute resolution mechanism: Expands options for developers by introducing commercial mediation and commercial arbitration as additional methods for resolving land disputes 	<ul style="list-style-type: none"> ● Improved Land Management: By focusing on the effective development and utilization of land funds, the new Chapter VIII encourages a more systematic and sustainable approach to land management. ● Agricultural Development: Encourages the consolidation of agricultural land, potentially increasing agricultural productivity, providing more flexibility in acquiring agricultural land, and allowing for larger agricultural plots. ● Land Accumulation Concerns: May raise concerns over land accumulation and the impact on small-scale farmers. ● Efficient Dispute Resolution: Developers have more options to resolve disputes.

Source: AMRO staff collection

Law on Real Estate Business

Amendments to the Real Estate Business Law 2024 are expected to enhance market transparency, protect homebuyers, and regulate developers more stringently (Table B2). These amendments reflect a concerted effort to regulate the real estate market more effectively, balancing the interests of developers with the need to protect homebuyers and maintain market stability. While they offer greater protection for homebuyers and aim to reduce speculative practices, developers may face new challenges such as cost of increased regulatory compliance. The overall impact is expected to foster a more transparent and secure real estate environment, though careful implementation and monitoring will be essential to address any unintended consequences.

Table B2. Key Amendments to the Law on Real Estate

Law on Real Estate Business: Key Amendments	Impacts and Challenges
<ul style="list-style-type: none"> ● Threshold on deposits collected by developers: <ul style="list-style-type: none"> ▪ Developers can only collect deposits from customers once the project has met all conditions, such as construction permits and completion of site clearance, required to be put into business. ▪ The deposit agreement must clearly state the selling price, and lease-purchase price of the construction project. ▪ The maximum deposit amount must not exceed 5 percent of the selling price or rental purchase price of the project. 	<ul style="list-style-type: none"> ● Preventing Abuse: Amendments on deposit collection timing, deposit transparency, and deposit cap are designed to prevent developers from misusing deposits to mobilize funds improperly. ● Buyer Protection: Enhances financial security for buyers by ensuring transparency and limiting upfront financial commitments.

<ul style="list-style-type: none"> ● Lowering the Maximum Upfront Payment Rate: The maximum upfront payment rate for properties under construction is reduced to 50 percent, down from 70 percent under the 2014 law. 	<ul style="list-style-type: none"> ● Motivating Developers: Encourages developers to accelerate project completion to receive the remaining payment. ● Protecting Homebuyers: Reduces financial risk for buyers by limiting the amount paid before project completion. ● Financing Constraints: Developers may face challenges in funding projects due to reduced upfront capital, potentially affecting smaller developers more significantly.
<ul style="list-style-type: none"> ● Transactions via banks: All real estate transactions are required to be conducted through banks. ● Bank guarantee: Developers must secure a guarantee for the completion of projects from a qualified commercial bank, before the sale or lease-purchase of a house that is under construction. This requirement may be waived at the buyer's option. 	<ul style="list-style-type: none"> ● Market Transparency: Promotes transparency in the real estate market by facilitating the creation of a comprehensive data system. ● Higher Costs: Banks may become more cautious when evaluating developers, applying stricter scrutiny before issuing guarantees. As a result, banks might increase guarantee costs or require additional collateral. It could raise costs for developers, eventually raising sale prices to homebuyers.

Source: AMRO staff collection

Law on Housing

The new amendments are designed to enhance affordability, expand eligibility for social housing, incentivize developers, and involve local authorities more closely in housing development plans (Table B3). The amendments are intended to make housing more affordable and accessible, particularly for vulnerable and underserved populations. By capping resale prices, expanding eligibility, offering incentives to developers, and involving local authorities more directly, the amendments aim to address housing shortages and curb speculative practices. However, challenges such as ensuring developer participation despite profit caps, managing increased demand, and effectively allocating resources at the local level need to be carefully managed. Their successful implementation will require collaboration between government bodies, developers, and communities to realize the intended benefits of these legislative changes.

Table B3. Key Amendments in Law on Housing

Law on Housing: Key Amendments	Impacts and Challenges
<ul style="list-style-type: none"> ● Resale Price Cap: Within five years of purchase, owners of social housing units can only resell their property to the social housing management authority or eligible buyers at a price not exceeding the original selling price specified in the sales contract. 	<ul style="list-style-type: none"> ● Preventing Speculation: Limiting the resale price helps prevent market speculation, ensuring that social housing remains affordable for low-income individuals. ● Maintaining Affordability: Keeping social housing units within the financial reach of the intended beneficiaries over time.
<ul style="list-style-type: none"> ● Expand the scope of individuals eligible to buy and rent social housing: Two additional groups include (1) Students of universities, vocational schools, and specialized schools according to the provisions of law; and (2) Students of ethnic schools and students in vocational schools of businesses, cooperatives, and unions of cooperatives in industrial parks. 	<ul style="list-style-type: none"> ● Addressing Housing Needs: More individuals have access to affordable housing, catering to diverse societal segments. ● Increased Demand: Expanding eligibility is likely to increase demand for social housing units. ● Medium-Term Market Impact: This may influence market dynamics and pricing, potentially making housing more accessible for low-income individuals and families.

	<ul style="list-style-type: none"> ● Supply Constraints: The surge in demand may put a strain on the existing social housing supply unless matched with increased development efforts.
<ul style="list-style-type: none"> ● Specify benefits for investors to develop social housing projects: <ul style="list-style-type: none"> ▪ Exemption from Land Use Fees and Rents: Developers are exempted from land use fees and land rents for land used in social housing construction. ▪ Support from Local Authorities: The authorities facilitate the integration of project site infrastructure with regional infrastructure to ensure well-connected social facilities both within and outside the project area. ▪ Commercial Use: Developers can use up to 20 percent of the total land area designated for social housing projects to build commercial housing (adopted from Decree No. 100/2015 and No. 49/2021). ▪ Maximum Profit of 10 percent: Developers are entitled to a maximum profit of 10 percent of the total investment cost for the social housing area. The commercial housing area is to be accounted for separately. ● Clarify Provincial People's Committee Responsibilities: Local authorities must allocate sufficient land for social housing development in line with approved provincial housing development programs and plans. 	<ul style="list-style-type: none"> ● Cost Reduction for Developers: Exemptions reduce overall project costs, making social housing projects more financially attractive. ● Incentivizing Development: The ability to develop a portion of land for commercial housing can offset the costs of social housing and increase profitability. ● Profit Margin Concerns: The profit margin cap remains at 10 percent, which may deter developers from investing in social housing. Limited profits may discourage the use of higher-quality construction materials and finishes. ● Tailored Housing Solutions: Empowers local authorities to adapt social housing plans to meet the specific needs and circumstances of their communities. ● Improved Implementation: Facilitates better coordination and implementation of social housing projects at the local level. ● Resource Allocation Challenges: Local governments may face challenges in identifying and allocating suitable land, especially in densely populated or high-demand areas

Source: AMRO staff collection

Authorities' views

43. The authorities view that the loan moratorium program, introduced through Circular 02/2023/TT-NHNN, does not obscure the underlying credit quality. They highlight the program's effectiveness in helping borrowers affected by the recent economic slowdown to continue accessing new loans and securing capital vital for investments and business operations, enabling eventual recovery and repayment of bank loans. As of the end of November 2024, the outstanding loans under this moratorium program program inclined over time from VND114.5 trillion in July 2024 to VND100.2 trillion in November 2024. This significant decline reflects the proactive and successful debt recovery efforts by credit institutions. Moreover, Circular 02/2023/TT-NHNN requires credit institutions to calculate specific provisions for all outstanding debts as if frozen debt classification regulations were not in effect, with a deadline to fully account for these provisions by December 31, 2024. This ensures that, by the deadline, credit institutions will have adequate financial buffers in place.

C.4 Fostering Inclusive and Sustainable Growth

44. Policy measures should be implemented to address structural challenges in physical infrastructure and human capital development.

- Upgrading infrastructure remains crucial and urgent. To reduce construction delays, laws related to public investment should be streamlined and updated. In addition to building power plants, enhancing the power grid, and importing electricity, the authorities should

consider leveraging the country's extensive coastline by investing in renewable energy sources such as solar and wind power to address the power shortage issues.

- Policies for human capital development should ensure that the quality and supply of the workforce are aligned with business needs, in order to improve labor productivity. This can be achieved by enhancing collaboration between firms and academic/vocational institutions through on-the-job training and the greater participation of employers in developing curriculums for technical and vocational education and training (TVET) institutions. Moreover, Vietnam's tertiary education system can be improved through greater provision of funding for research, as well as enhanced efforts on international benchmarking, such as international accreditation, exchange programs, and the incorporation of more English-language courses.

45. MSMEs' access to finance must be enhanced so that they can invest in improving their capabilities and the quality of their products. For banks, improving the process of evaluating loan requests may help them better understand MSMEs' financial needs and risks, and thus lower the amount of required collateral. The authorities may consider establishing a separate agency to help MSMEs develop business plans and prepare financial statements, which will allow banks to better conduct risk assessment and facilitate the approval process. As far as trade finance is concerned, from a regulatory perspective, adjustments to banks' customer limits may be considered with a view to easing the rules on trade credits, thus enhancing access of MSMEs to trade finance products.

46. There is a need for more proactive government policies to prevent cyber-attacks in view of rapid digitalization. Public and private agencies should put in place sound risk management practices to reduce the risks associated with cyberattacks, scams, and money laundering. Comprehensive consumer and investor protection programs as well as public awareness should be enhanced further. As cyber-attacks often tend to be cross-border, the government should work closely with other governments and international agencies to share information on cyber risks and combat cross-border cybercrimes

47. The coordination and implementation of climate change response activities and the mobilization of green finance should be improved. Enhancing inter-ministerial and inter-sectoral coordination is necessary to ensure the effective transmission of policies from ministries to localities. The green economy is emerging as a key growth driver for Vietnam, fueled by increasing demand for low-carbon products. The government should expedite the implementation of the Vietnam Green Growth Strategy to expand the use of green technologies and promote more sustainable economic growth. Sustainable financial products should be promoted by developing an ESG bond market and a green taxonomy. Mobilizing private-sector capital to supplement public funding is crucial for securing the necessary investment in green infrastructure.⁵⁹ In this regard, public-private partnerships (PPPs) could be an alternative or complement to fiscal spending. Existing regulations on PPPs should be reviewed to address challenges that hinder private participation and generate sufficient incentives for them to contribute to climate change mitigation efforts.

48. Given Vietnam's rapidly aging population, enhancing the financial sustainability and transparency of the social insurance fund is essential. The Vietnamese government has implemented social security reforms aimed at expanding social insurance coverage and

⁵⁹ According to the World Bank, Vietnam needs to invest approximately USD 368 billion from now until 2040, equivalent to 6.8 percent of GDP, to build a climate resilient and low-carbon economy. Total financing needs are estimated at around USD 254 billion from 2022 to 2040, including USD 219 billion for upgrading private assets and public infrastructure, plus USD 35 billion for social programs. Although there have been policies, plans, and programs for climate change adaptation, and resources have been focused on implementation thus far. Financial resources have only meet about 30 percent of the total financing needs while the cost of responding to climate change in Vietnam is predicted to exceed 3-5 percent of GDP by 2030.

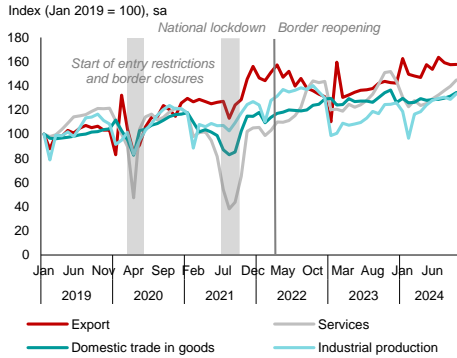
enhancing the capacity, effectiveness, and efficiency of public social insurance system since 2018. AMRO supports the Amended Law on Social Insurance, approved in June 2024, which aims to expand its coverage and increase its revenue, particularly given the social insurance fund could be in deficit from 2035. It is advisable for the fund to explore alternative investment assets and overseas markets to achieve higher yields and enhance risk diversification to address falling investment returns. Additionally, increasing transparency – by enhancing the frequency of state and external audits and providing more comprehensive disclosure of the social insurance fund’s operations – can help boost public confidence in the social security system.

Appendices

Appendix 1. Selected Figures for Major Economic Indicators

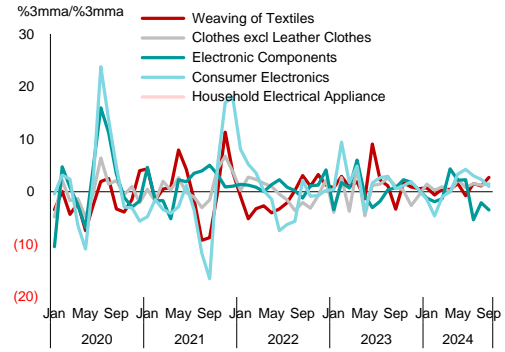
Figure 1.1. Real Sector

Vietnam's economy continues its recovery in 2024,



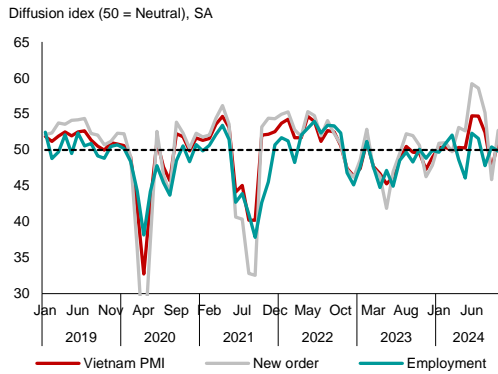
Source: GSO via CEIC; AMRO staff estimations

...led by a rebound of textile, garment and consumer electronics exports.



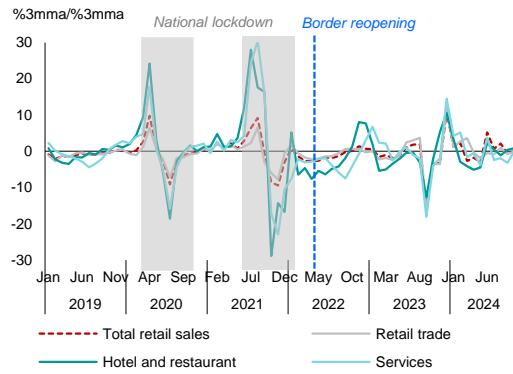
Source: GSO via CEIC; AMRO staff calculation

Vietnam saw an increase in new orders during the first half of the year.



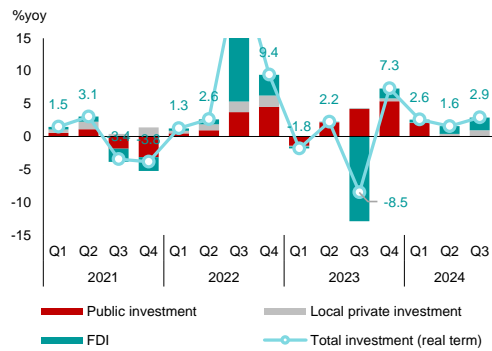
Source: S&P Global Market Intelligence via Haver Analytics

Domestic retail sales remained stagnant.



Source: GSO via CEIC; AMRO staff calculation

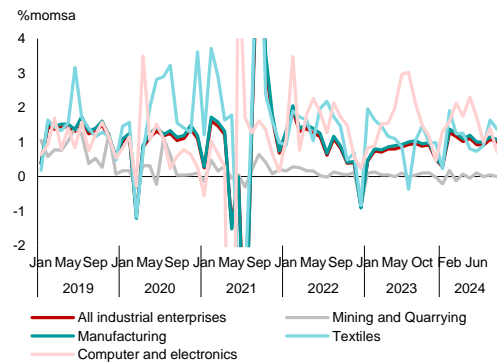
FDI is the main driver of investment.



Source: GSO via CEIC; AMRO staff calculation

Note: Real-term investment is calculated by dividing the nominal investment value by the GDP deflator.

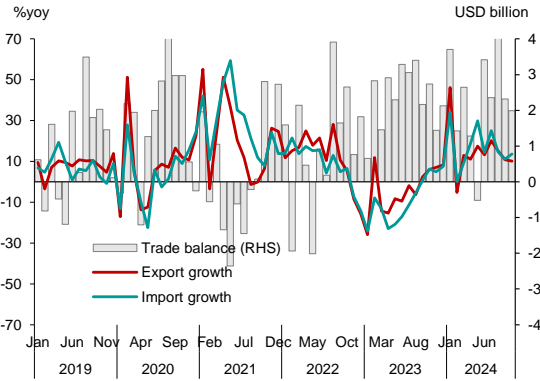
Employment in key sectors i.e. textiles and ICT improved.



Source: GSO via CEIC; AMRO staff calculation

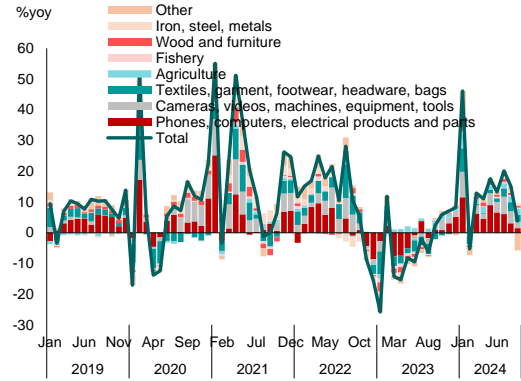
Figure 1.2. External Sector

The trade balance recorded a surplus, thanks to improving exports,



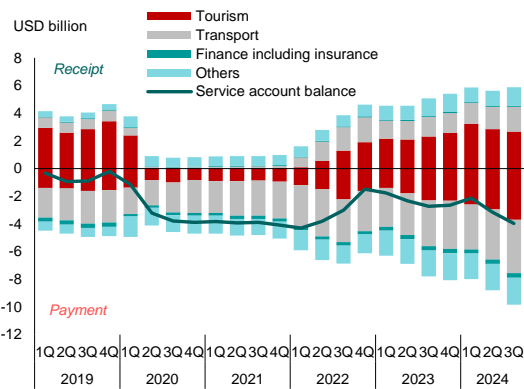
Source: GSO via CEIC; AMRO staff calculation

... driven mainly by the exports of wood furniture, electronics products, and home appliances.



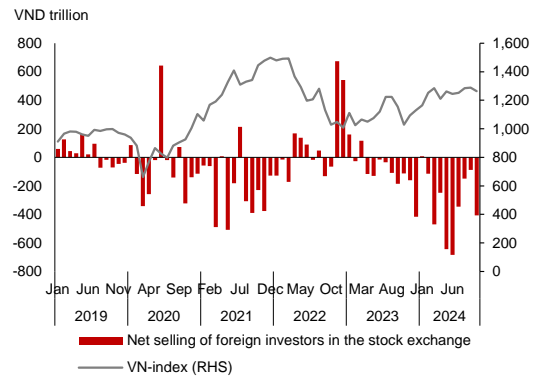
Source: GSO via CEIC; AMRO staff calculation

The service account deficit widened due to rising shipping costs.



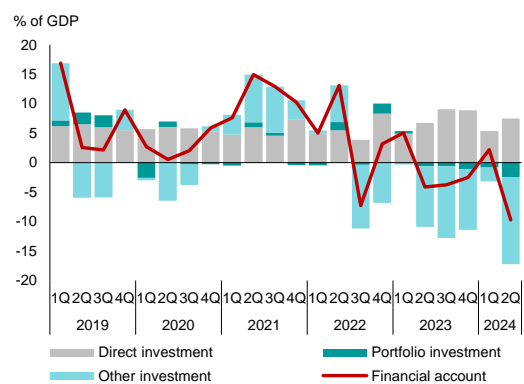
Source: SBV via CEIC

Foreign investors sold off their equity holdings to lock in profits,



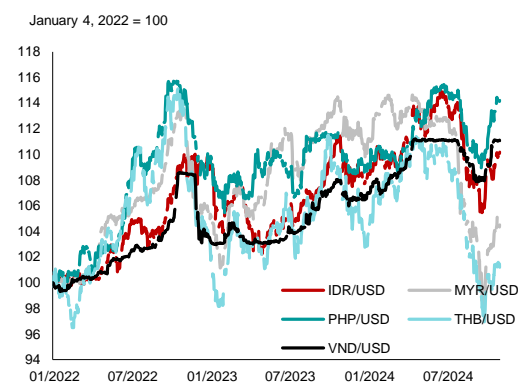
Source: HNX via CEIC

... leading to portfolio and other investment outflows.



Source: SBV via CEIC

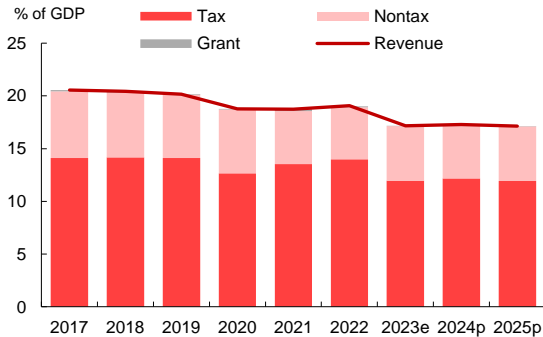
In H2, the VND appreciated against the USD, in line with other regional currencies.



Source: National authorities; Vietcombank; Haver Analytics; AMRO staff calculations

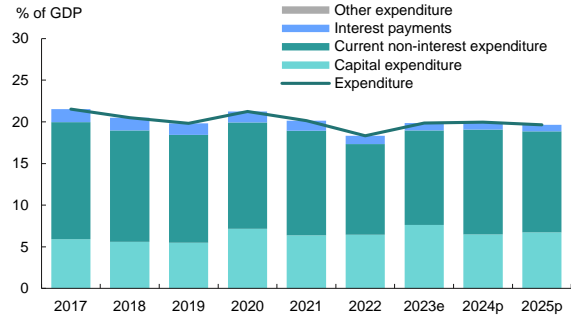
Figure 1.3. Fiscal Sector

In 2025, revenue as a percentage of GDP is anticipated to slightly decrease compared to 2024.....



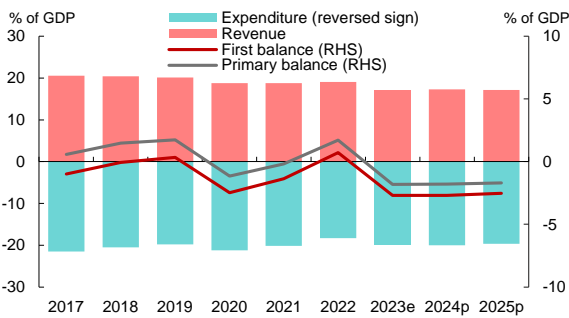
Source: MOF via Haver Analytics; AMRO staff calculation

...while expenditure as a percentage of GDP also decreased despite the higher capital expenditure compared to 2024.



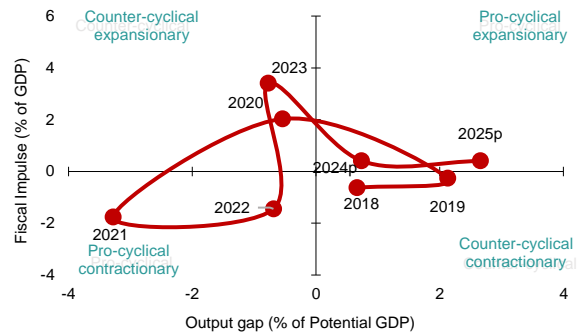
Source: MOF via Haver Analytics; AMRO staff calculation

The fiscal deficit in 2025 is projected to slightly narrow compared to 2024.



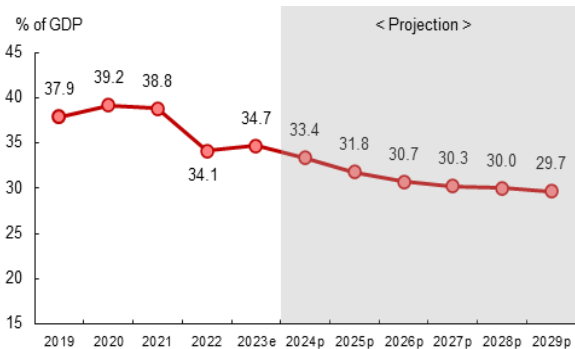
Source: MOF via Haver Analytics; AMRO staff calculation

Fiscal stance for 2025 projection is assessed to be neutral.



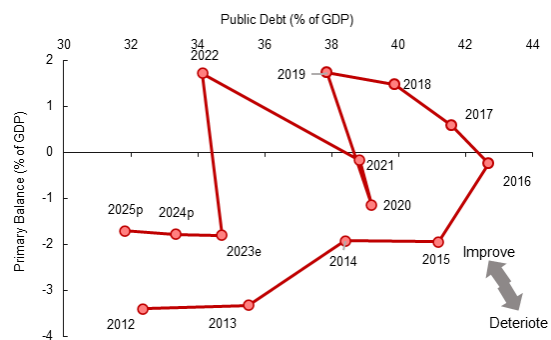
Source: MOF via Haver Analytics; AMRO staff calculation

Public debt to GDP ratio is expected to decline.



Source: MOF via Haver Analytics; AMRO staff calculation

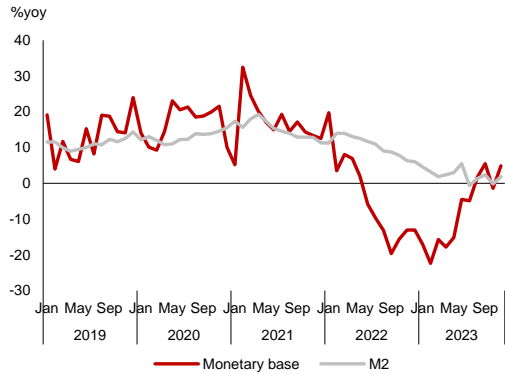
Overall fiscal position in 2025 would marginally improve from 2024.



Source: MOF via Haver Analytics; AMRO staff calculation

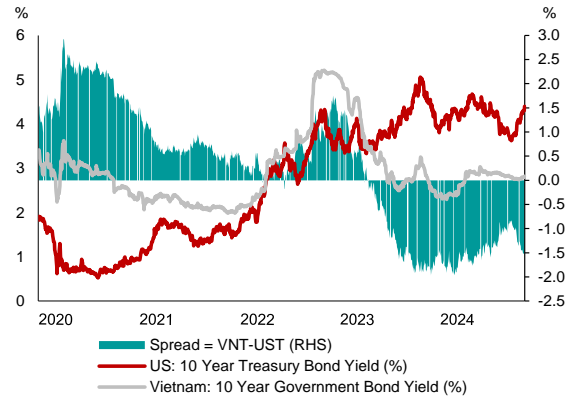
Figure 1.4. Monetary and Financial Sector

The monetary base expanded in late 2023.



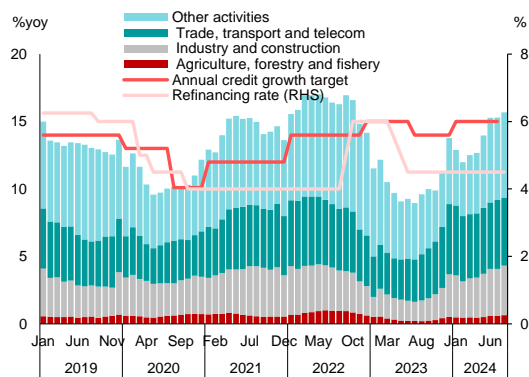
Source: IMF; SBV via CEIC; AMRO staff calculations

The interest rate gap between the U.S. and Vietnam narrowed after the Fed's rate cut.



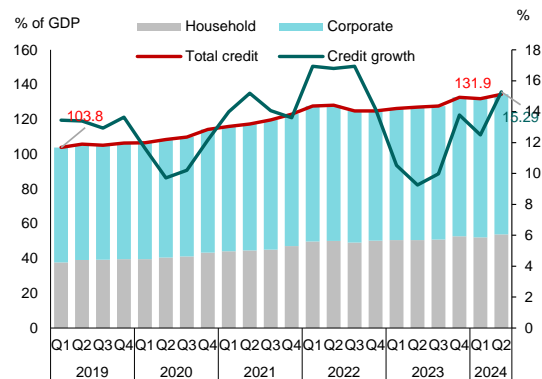
Source: US Federal Reserve; London Stock Exchange Group via Haver Analytics; AMRO staff calculations

Although the ytd growth of bank loan remained well below the indicative target, the on-year growth was more than 15 percent in August 2024.



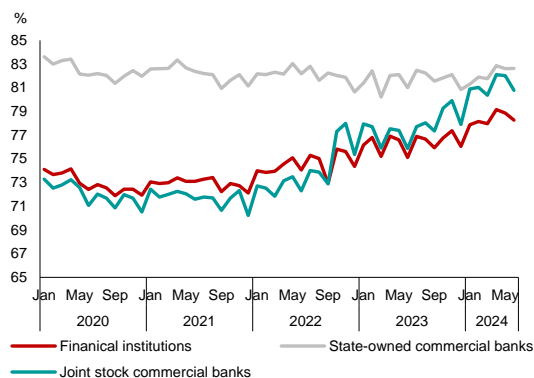
Source: SBV via CEIC; AMRO staff calculations

The majority of bank loans are directed toward corporate borrowers.



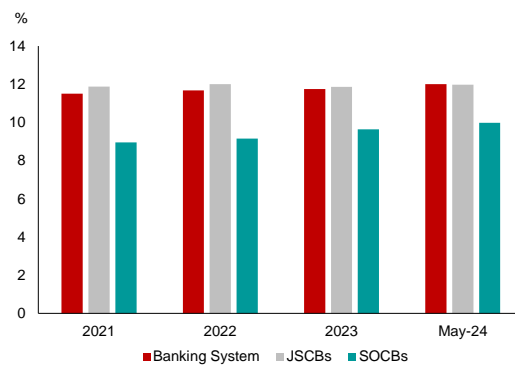
Source: GSO; SBV via CEIC; AMRO staff calculations

Commercial banks faced tighter liquidity conditions due to loan growth.



Source: SBV via Haver Analytics; AMRO staff calculations

The average capital adequacy ratio of banks stood at 12.0 percent, above the regulatory requirement but significantly below that in regional peers.



Source: SBV via CEIC

Appendix 2. Selected Economic Indicators for Vietnam

	2020	2021	2022	2023	Projections	
					2024	2025
National income and prices	(In annual percentage change, unless otherwise specified)					
Real GDP	2.9	2.6	8.1	5.0	6.5	6.7
Consumer price inflation	3.2	1.8	3.2	3.3	3.8	3.2
Core inflation	2.3	0.8	2.6	4.2	2.7	3.1
Balance of payments	(In billions of U.S. dollars, unless otherwise specified)					
Current account balance	15.1	-8.1	1.4	25.1	20.9	27.3
<i>In percent of GDP</i>	4.3	-2.2	0.3	5.8	4.4	5.1
Trade balance	30.7	15.7	29.4	44.0	39.0	50.1
<i>In percent of GDP</i>	8.8	4.2	7.2	10.2	8.2	9.4
Service balance	-10.3	-15.7	-13.9	-9.5	-9.1	-11.0
Primary income	-14.8	-16.7	-19.7	-22.5	-17.0	-20.8
Secondary income	9.5	10.3	5.6	13.1	8.0	8.9
Financial and capital account balance	8.5	30.8	9.5	-2.8	-1.5	5.8
<i>In percent of GDP</i>	2.4	8.3	2.3	-0.7	-0.3	1.1
Direct investment, net	15.4	15.3	15.2	20.1	19.0	20.5
Portfolio investment, net	-1.3	0.3	1.5	-1.2	-2.0	0.5
Other investment, net	-5.7	15.3	-7.3	-21.7	-18.5	-15.2
Net errors and omissions	-6.9	-8.4	-33.6	-16.6	-18.6	-15.0
Overall balance	16.6	14.3	-22.7	5.6	0.8	18.1
Gross international reserves	95.5	110.0	87.2	92.8	93.7	111.7
<i>In months of imports of goods & services</i>	4.2	3.9	2.8	3.3	3.0	3.3
Coverage of short-term debt	3.6	3.3	2.3	2.9	2.2	2.3
Total external debt/GDP	37.3	37.6	35.7	36.1	34.6	33.1
Short-term/total external debt	20.5	23.8	26.0	20.9	25.2	27.3
General government 1/	(In percent of GDP)					
Revenue and grants	18.8	18.8	19.1	17.2	17.3	17.1
Expenditure	21.3	20.1	18.3	19.8	19.9	19.7
of which current expenditure	12.8	12.6	10.9	11.3	12.6	12.1
of which capital expenditure	7.2	6.4	6.4	7.6	6.5	6.7
Fiscal balance	-2.5	-1.4	0.7	-2.7	-2.6	-2.5
Public debt	39.2	38.8	34.1	35.2	33.4	31.8
Monetary sector	(In annual percentage change unless otherwise specified)					
Domestic private credit	12.4	12.6	11.5	13.6	...	...
<i>In percent of GDP</i>	127.4	135.5	136.1	145.0	...	...
Broad money	14.5	10.7	6.2	12.5	...	...
Monetary base	10.1	12.5	-13.1	11.1	...	...
Memorandum items:						
Exchange rate (USD/VND), period average	23,150	22,833	23,263	23,660	...	...
Exchange rate (USD/VND), end of period	23,035	22,640	23,410	24,080	...	...
Nominal GDP in billions of USD	347.5	371.7	410.5	432.0	478.6	531.1
Nominal GDP in trillions of VND	8,044	8,487	9,549	10,222	11,323.8	12,564.9

Source: Data provided by Vietnamese authorities; AMRO staff estimates

Note: 1/ The pre-2021 public debt-to-GDP ratio is computed based on the recalibrated GDP figures released since 2021.

2/ The general government indicators in 2023 are based on AMRO staff estimates.

Appendix 3. Balance of Payments

	2020	2021	2022	2023	Projections	
					2024	2025
	(In billions of U.S. dollars, unless otherwise specified)					
Current account balance	15.1	-8.1	1.4	25.1	20.9	27.3
Trade balance	30.7	15.7	29.4	44.0	39.0	50.1
Exports of goods	282.6	336.2	371.3	353.9	397.3	437.0
Imports of goods	251.9	320.5	345.6	311.8	358.2	386.9
Services account balance	-10.3	-15.7	-13.9	-9.5	-9.1	-11.0
Exports of services	7.6	4.2	13.5	19.6	13.1	14.0
Imports of services	17.9	19.9	27.4	29.1	22.2	25.0
Primary income balance	-14.8	-16.7	-19.7	-22.5	-17.0	-20.8
Secondary income balance	9.5	10.3	5.6	13.1	8.0	8.9
Financial account balance	8.5	30.8	9.5	-2.8	-1.5	5.8
Direct Investment: Net	15.4	15.3	15.2	20.1	19.0	20.5
Portfolio Investment: Net	-1.3	0.3	1.5	-1.2	-2.0	0.5
Other Investment: Net	-5.7	15.3	-7.3	-21.7	-18.5	-15.2
Net Errors & Omissions	-6.9	-8.4	-33.6	-16.6	-18.6	-15.0
Overall Balance	16.6	14.3	-22.7	5.6	0.8	18.1
Gross international reserves	95.5	110.0	87.2	92.8	93.7	111.7
In months of imports of goods & services	4.2	3.9	2.8	3.3	3.0	3.3
Coverage of short-term debt	3.6	3.3	2.3	2.9	2.2	2.3
	(In percent of GDP)					
Current account	4.3	-2.2	0.3	5.8	4.4	5.1
Trade balance	8.8	4.2	7.2	10.2	8.2	9.4
Financial account	2.4	8.3	2.3	-0.7	-0.3	1.1
Direct investment	4.4	4.1	3.7	4.6	4.0	3.9
Portfolio Investment	-0.4	0.1	0.4	-0.3	-0.7	0.2
Other Investment	-1.6	4.1	-1.8	-5.0	-3.9	-2.9
Net Errors & Omissions	-2.0	-2.3	-8.2	-3.9	-3.9	-2.8
Overall balance	4.8	3.8	-5.5	1.3	0.2	3.4
External debt	37.3	37.6	35.7	36.1	34.6	33.1
Short term debt	7.7	8.9	9.3	7.5	8.7	9.0
Medium-to-long term debt	29.5	28.1	26.0	28.5	25.9	24.1

Source: Data provided by Vietnamese authorities; AMRO staff estimates

Appendix 4. Statement of General Government Operations

	2020	2021	2022	2023	Projections	
					2024	2025
<i>(In trillions of Vietnamese dong, unless otherwise specified)</i>						
Revenue and Grants (1)	1,511	1,591	1,820	1,754	1,967	2,165
Tax revenue	1,019	1,148	1,335	1,223	1,384	1,506
Value added tax	340	376	445	420	457	498
Corporate income tax	257	319	339	362	435	474
Personal income tax	115	128	163	157	179	195
Excise tax	100	102	136	115	111	122
Trade tax	79	90	114	87	90	98
Other taxes	128	134	138	81	112	119
Non-tax revenue	487	426	472	528	580	657
Grants	5	17	8	3	3	3
Expenditures (2)	1,710	1,708	1,751	2,028	2,266	2,484
Current non-interest expenditure	1,027	1,066	1,040	1,159	1,432	1,532
Interest payments	106	102	95	89	96	103
External	15	14	13	13	13	14
Domestic	89	87	81	75	82	88
Capital expenditure	576	540	616	780	738	849
Overall balance	-199	-117	70	-274	-299	-319
Primary balance	-92	-15	164	-185	-203	-216
Principal payment	248	262	214	190	241	258
<i>(In percent of GDP, unless otherwise specified)</i>						
Revenue and Grants (1)	18.8	18.8	19.1	17.2	17.3	17.1
Tax revenue	12.7	13.5	14.0	12.0	12.2	11.9
Value added tax	4.2	4.4	4.7	4.1	4.0	3.9
Corporate income tax	3.2	3.8	3.6	3.5	3.8	3.8
Personal income tax	1.4	1.5	1.7	1.5	1.6	1.5
Excise tax	1.2	1.2	1.4	1.1	1.0	1.0
Trade tax	1.0	1.1	1.2	0.9	0.8	0.8
Other taxes	1.6	1.6	1.4	0.8	1.0	0.9
Non-tax revenue	6.1	5.0	4.9	5.2	5.1	5.2
Grants	0.1	0.2	0.1	0.0	0.0	0.0
Expenditures (2)	21.3	20.1	18.3	19.8	19.9	19.7
Current non-interest expenditure	12.8	12.6	10.9	11.3	12.6	12.1
Interest payments	1.3	1.2	1.0	0.9	0.8	0.8
External	0.2	0.2	0.1	0.1	0.1	0.1
Domestic	1.1	1.0	0.8	0.7	0.7	0.7
Capital expenditure	7.2	6.4	6.4	7.6	6.5	6.7
Overall balance	-2.5	-1.4	0.7	-2.7	-2.6	-2.5
Primary balance	-1.1	-0.2	1.7	-1.8	-1.8	-1.7
Public debt	39.2	38.8	34.1	34.7	33.4	31.8
External	14.1	12.7	10.2	10.0	9.2	8.6
Domestic	25.1	26.2	23.9	24.8	24.2	23.3
Memorandum						
Interest payment / State revenue (%)	7.0	6.4	5.2	5.1	4.9	4.7
Interest payment / Expenditure (%)	6.2	6.0	5.4	4.4	4.2	4.1
Principal and interest payment / State Revenue (%) : DSR	23.5	22.8	17.0	16.0	17.1	16.7
Effective interest rate (%)	3.6	3.2	2.9	2.7	2.7	2.7

Source: Data provided by Vietnamese authorities; AMRO staff estimates

Note: 1/ The pre-2021 public debt-to-GDP ratio is computed based on the recalibrated GDP figures released since 2021.

2/ The general government indicators in 2023 are based on AMRO staff estimates.

Appendix 5. Debt Sustainability Analysis^{60,61}

1. Vietnam's public debt-to-GDP ratio is projected to decline gradually, and gross financing needs (GFNs) are expected to fall as well (Table 5.1). Strong real GDP growth and stable interest rates will lead to a reduction in the debt ratio, offsetting the contribution from the primary deficit (Figure 5.1). Average real GDP growth from 2024 to 2029 is projected to be 6.4 percent, in line with the potential growth rate. The effective interest rate is projected to be maintained at a low level until 2029, reflecting a substantial portion of ODA is in public debt and the authorities' efforts to curb the government's financing cost. Despite increased expenditure from salary reform and public investments, the fiscal deficit-to-GDP ratio is expected to decline gradually by the end of projection period, backed by strong revenue growth resulting from tax reforms. The financing of salaries reform through salary reform fund will contribute to the downward trend of public debt, because it reduces the need of new bond issuances⁶². The primary deficit is expected to stay around 1.7 to 1.8 percent of GDP over the medium term, leading to a stability of GFN-to-GDP ratio, around 4.3 percent of GDP by the end of the period (Figure 5.1).

2. A standard debt sustainability analysis (DSA) finds that the overall risk of public debt sustainability is low (Figure 5.4). The public debt-to-GDP ratio and the GFNs as a percentage of GDP have remained below their corresponding thresholds over the past five years, and are projected to stay lower than the thresholds in the baseline and all stress test scenarios over the projection period (Figure 5.2). Moreover, market perception of sovereign risk continues to be low, as indicated by the emerging markets bond index (EMBI) spread. Although the share of debt held by non-residents⁶³ are below the upper early-warning threshold and showed downward trend, the risk related to exchange rate volatility still exists and could affect the government's capacity to repay. The proportion of ODA and concessional loans in total public debt was around 28.5 percent in 2023. Meanwhile, rollover risk is contained thanks to the high proportion of long-term debt with low interest rates. The external financing requirements are expected to decline due to the improvement of the current account and the downtrend of external debt proportion in the public debt (Figure 5.3).

Table 5.1. Macroeconomic and Fiscal Indicators

	2019	2020	2021	2022	2023e	2024p	2025p	2026p	2027p	2028p	2029p
Macroeconomic indicators (Percent)											
Real GDP growth	7.4	2.9	2.6	8.1	5.0	6.5	6.7	6.3	6.3	6.3	6.3
GDP deflator	2.4	1.5	2.9	4.1	1.9	4.5	4.0	3.5	3.5	3.5	3.5
Effective interest rate	3.8	3.6	3.2	2.9	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Fiscal indicators (Percent of GDP)											
Revenue	20.2	18.8	18.8	19.1	17.2	17.3	17.1	17.1	17.2	17.2	17.3
Expenditure	19.8	21.3	20.1	18.3	19.8	19.9	19.7	19.6	19.9	19.8	19.7
Fiscal balance	0.3	-2.5	-1.4	0.7	-2.7	-2.6	-2.5	-2.5	-2.7	-2.6	-2.5
Primary balance	1.7	-1.1	-0.2	1.7	-1.8	-1.79	-1.71	-1.70	-1.97	-1.83	-1.72
Public debt	37.9	39.2	38.8	34.1	34.7	33.4	31.8	30.7	30.3	30.0	29.7
Gross financing needs	2.0	5.6	4.5	1.5	4.5	4.7	4.6	4.4	4.6	4.5	4.3

Source: Ministry of Finance, AMRO projections (p)

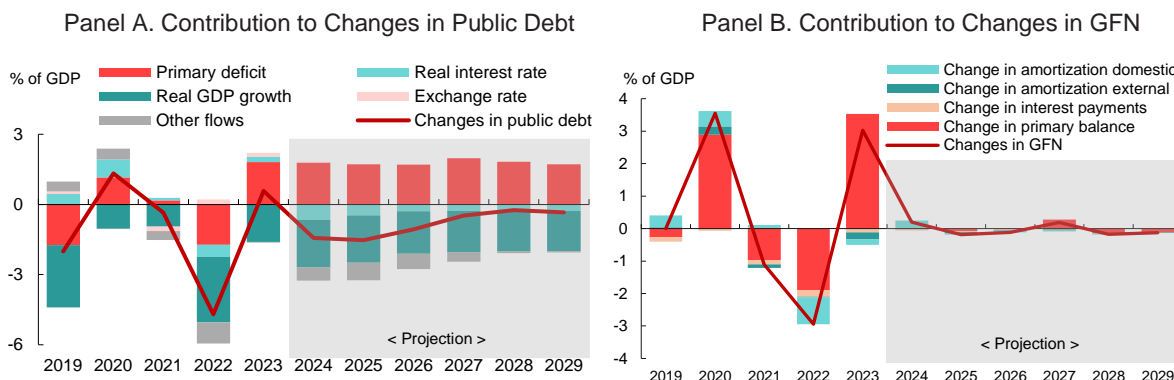
⁶⁰ Prepared by Ginanjar Wibowo, Fiscal Sector Specialist, and Tran Van Duc, Associate.

⁶¹ Public DSA for Vietnam covers national government debt (central and local governments), and excludes government guaranteed debt. As of end-2022, national government debt stood at 34 percent of GDP, while the government guaranteed debt was at 3.1 percent of GDP.

⁶² Over the past years, the government has accumulated the salary reform fund (sourced from the extra revenue and savings in expenditure) to finance the salary reform program. To finance the 30-percent increase of base salary in 2024, amounting to VND226 trillion, the government allocates VND 74 trillion from the 2024 budget and the remaining VND152 trillion is withdrawn from the salary reform fund. The utilization of the salary reform fund is anticipated to continue in the coming years to support ongoing salary reform program. The salary reform fund is reflected in other flows (gray bar) in Figure 5.1 panel A.

⁶³ Vietnam's external financing sources are significantly dominated by ODA and concessional loans. Given no data is available for government bond held by non-residents, the share of ODA and concessional loans in the public debt could be used to mirror the public debt held by non-residents in the case of Vietnam.

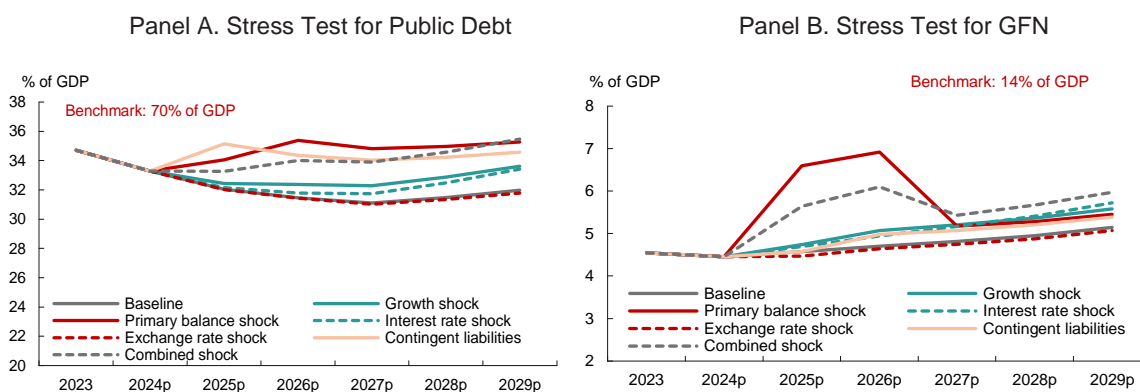
Figure 5.1. Public Debt and GFN Dynamics



Source: Ministry of Finance, AMRO projections (p)

Source: Ministry of Finance, GSO, AMRO projections (p)

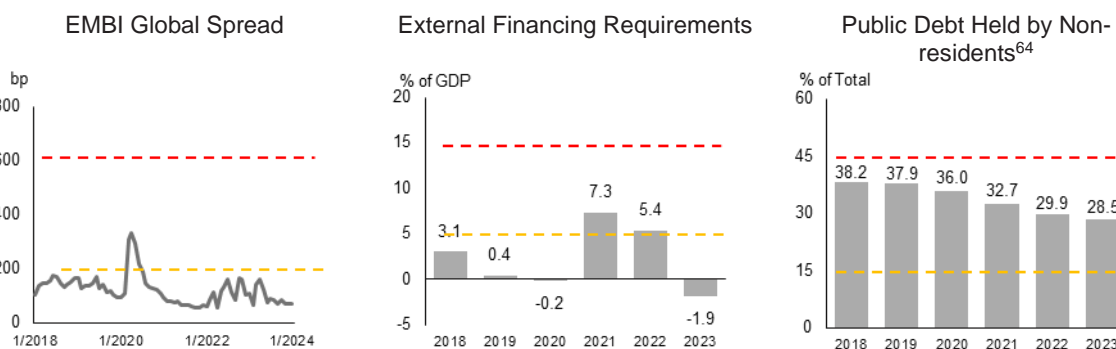
Figure 5.2. Macro-Fiscal Stress Test



Note: The scenarios for the stress test are as follows: 1) Real GDP growth shock: one standard deviation or -0.7 percentage point shock in 2025 and 2026; 2) Primary balance shock: one standard deviation or -2.0 percent of GDP shock in 2025 and 2026; 3) Interest rate shock: $+3$ percentage point shock from 2025; 4) Exchange rate shock: one-time $+2.8$ percentage point shock in 2025; 5) Contingent liability shock: one-time 3.1 percent of GDP shock in 2025, by recognizing government guaranteed debt as of end 2024; 6) Combined shock: a combination of growth (half size), primary balance (half size), interest rate, and exchange rate shocks.

Source: Ministry of Finance; AMRO staff estimates

Figure 5.3. Debt Profile Vulnerabilities



Note: 1) $---$ Lower early warning (50 percent of the benchmark), $---$ upper early warning (75 percent of the benchmark); 2) External financing requirements = current account deficit + amortization of public external debt + amortization of private external debt.

Source: Ministry of Finance; AMRO staff estimates

⁶⁴ In Vietnam, non-residential debt holders can be referred to as external creditors (ODA and concessional loans).

Figure 5.4. Heatmap of Public Debt Sustainability

		2018	2019	2020	2021	2022	2023p	2024p	2025p	2026p	2027p	2028p	2029p
Public Debt													
Gross Financing Needs													
Debt Profile	Market Perception of Sovereign Risk												
	External Financing Requirement												
	Public Debt Held by Non-residents												

Note 1) For Public Debt and Gross Financing Needs, the cell is highlighted in green if the benchmark is not exceeded under all shocks or the baseline, yellow if exceeded under any specific shock but not the baseline, and red if exceeded under the baseline; 2) For Debt Profile, the cell is highlighted in green if the country value is less than the lower early warning benchmark, red if it exceeds the upper early warning benchmark, and yellow if it lies between the lower and upper early warning benchmarks.

Source: AMRO staff estimates

Appendix 6. Climate Change Policy Fact Sheet

Item	Sub-item	Note				
Nationally Determined Contribution (NDC)	Submission	<ul style="list-style-type: none"> Vietnam updated its NDC in October 2022. 				
	GHG emission reduction targets by 2030	<ul style="list-style-type: none"> Total emissions of greenhouse gases (GHGs) in 2020 amounted to 528.4 million tonnes of carbon dioxide equivalent (MtCO₂eq). The government analyzes projected GHG emissions under three scenarios: business-as-usual (BAU), unconditional mitigation and conditional mitigation. The BAU scenario was developed based on the assumption of economic growth in the absence of climate change response policies. Unconditional mitigation aims to reduce total GHG emissions by 15.8 percent by 2030 compared with the BAU level, equivalent to 146.3 MtCO₂eq, through the use of the state budget, loans, investments from domestic and foreign enterprises, and citizen contributions and investments. Conditional mitigation aims to reduce total GHG emissions by 43.5 percent by 2030 compared with BAU, equivalent to 403.7 MtCO₂eq, with international financing. 				
		(Units: MtCO ₂ eq, USD billion)		2020	2030	Financial needs
		BAU		528.4	927.9	-
		Unconditional		443.4	781.6 (-146.3)	21.7
		Conditional		443.4	524.2 (-403.7)	86.8
	Mitigation	5 Sectors	Key subsectors	Unconditional GHG reduction of total 146.3 (ktCO₂eq)	Conditional GHG reduction of total 403.7 (ktCO₂eq)	Financial needs out of total 21.7 / 86.8 (USD billion)
		Energy	<ul style="list-style-type: none"> Energy industry Industrial production Construction Transport Households Services Trade 	64.8	227.0	Unconditional 14.5 / Conditional 60.6
		Agriculture	<ul style="list-style-type: none"> Rumen digestion Organic fertilizer management Rice cultivation 	12.4	50.9	2.1 / 16.1
		Land use, land-use change and forestry	<ul style="list-style-type: none"> Forest land Cultivated land Grassland 	32.5	46.6	3.9 / 5.5
		Waste	<ul style="list-style-type: none"> Landfills Materials production from solid waste Domestic and industrial wastewater treatment 	8.7	29.4	0.9 / 2.7
		Industrial processes	<ul style="list-style-type: none"> Construction materials Chemical industry Hydrofluorocarbon consumption 	27.9	49.8	0.3 / 2.0
		Adaptation	Scenario of high climate change	<ul style="list-style-type: none"> Temperature: annual increase of 1.7-2.3°C by 2050, 3.2-4.2°C by 2100 Rainfall: annual increase of 10-15 percent by 2050, 10-25 percent by 2100 Sea level: average rise of 73cm along Vietnam's entire coastline by 2100 		
Loss and damage	<ul style="list-style-type: none"> 2011-2020: VND229,958 billion (USD10 billion), 3.2 percent of GDP 2021-2030: Temperature increases of 1.0°C and 1.5°C could cause losses of 1.8 percent and 4.5 percent of GDP, respectively. If sea levels rise according to the scenario of high climate change, 3.1 million people will have to relocate domestically by 2050. 					

		Adaptation policy measures	<ul style="list-style-type: none"> • Putting in place climate monitoring and early warning of natural disasters • Planning a natural disaster response, flood prevention for major cities, reinforcement of river dikes and sea dikes, and reservoir safety • Ensuring food and water security • Building climate-resilient communities • Protecting and sustainably developing forests and preserving bio-diversity
Climate Finance	Financial needs	(NDC)	<ul style="list-style-type: none"> • To realize unconditional and conditional contributions that aim to reduce GHG emissions by 15.8 percent and 43.5 percent by 2030 over the BAU level, Vietnam's incremental financing needs are USD21.7 billion and USD86.8 billion, respectively. • The financing needs of climate change adaptation for 2021-2030 are estimated to exceed 3-5 percent of 2020 GDP, equivalent to between USD55 billion and USD92 billion according to the 2020 net present value at a 10 percent discount. <p>(World Bank)</p> <ul style="list-style-type: none"> • Pursuing a combined mitigation and adaptation approach is estimated to require additional investment of about 6.8 percent of GDP per year for 2022-2040, equivalent to USD368 billion according to the 2022 net present value at a 6 percent discount.
	Resources		<ul style="list-style-type: none"> • Funding from the state budget, with a focus on capital sources from public investment plans and regular spending on programs, schemes, projects and tasks about the climate change response. • Loans and funding from domestic and foreign businesses and individuals. Cooperation between the public and private sectors, and between domestic and foreign investors in climate change response programs and projects. • Funding from financial institutions, funds and international private investors, concessional loans and official development assistance. Technical assistance from countries and from international organizations and non-governmental organizations that are responding to climate change. • Financial resources, technology and capacity building under bilateral and multilateral international cooperation mechanisms, especially within the frameworks of the UN Framework Convention on Climate Change (UNFCCC) and Paris Agreement. • Financing through carbon market and carbon pricing mechanisms.
	Multilateral climate finance	<u>UNFCCC financial mechanism funds</u>	<ul style="list-style-type: none"> • Adaptation fund: USD7 million from UN-Habitat to enhance small-scale infrastructure interventions in the coastal regions of the Mekong Delta • Global Environmental Facility Trust Fund (GEF/TF): Total of USD72.3 million to support 18 mitigation projects • Least Developed Countries Fund (LDCF) • Green Climate Fund (GCF) • GEF Small Grants Programme (GEF-SGP) <p><u>Non-UNFCCC financial mechanism funds</u></p> <ul style="list-style-type: none"> • UN: UN-REDD Viet Nam Phase II Programme via UN-REDD Viet Nam Phase II Multi Partner Trust Fund • World Bank: GCF will provide USD86.3 million to spur energy efficiency investments. Other contributors through the World Bank Group are the Transformative Carbon Asset Facility (TCAF), Scaling Climate Action by Lowering Emissions (SCALE), Climate Investment Funds (CIFs), Forest Investment Program (FIP), Forest Carbon Partnership Facility (FCPF) and Partnership for Market Implementation (PMI). • Asian Development Bank: GCF, Urban Climate Change Resilience Trust Fund, and Clean Technology Fund (CTF) of Climate Investment Fund • NDC partnership funds: Global Climate Partnership Fund, Low Carbon Transition in the EE sector, GCF, Capacity Building Initiative for Transparency (CBIT) Trust Fund, CTF and others
	Bilateral climate finance		<ul style="list-style-type: none"> • US (USAID): USD2.5 million Innovation Challenge Fund to support innovative energy solutions, Renewable Energy Data Explorer tool • EU: Global Climate Change Alliance Plus (GCCA+) • UK: International Climate Fund (UK-ICF) • JP: Actions for Cool Earth 2.0 (ACE 2.0), Japan's Fast Start Finance (J-FSF)

Source: Vietnam NDC; UN; World Bank; USAID; GCCA+

Appendix 7. 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 is available for both expenditure and production approaches. Quarterly GDP data by expenditure, however, is unavailable. Headline CPI and core inflation data have been released since 2015 using the geometric means method. Current CPI data has been rebased to 2019 (previous base year: 2014) with a new CPI basket weight system based on 2019 consumption. The General Statistics Office (GSO) adjusts basket weights and base year every 5 years.	Estimated GDP data is released within the final week of each quarter; while revised data is 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. The underlying index of core inflation is unavailable.	Historical GDP data for 2017-2019 using the new base of 2010 is unavailable, making comparison across time difficult. Reevaluated GDP by expenditure is not publicly available.	-
Balance of Payments and External Position	-	Quarterly balance of payments data is released on the SBV website with a time lag of 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 is available. Data on debt of state-owned-enterprises (SOEs) is published on the MOF website.	The latest Debt Bulletin (in Vietnamese) was released on March 06, 2024. The previous Bulletin was released on September 29, 2023.	Certain government borrowings are excluded from the budget data (such as on-lending debts to enterprises and public service units). Public debt covers central government debt, local government debt and central government guaranteed debt only. SOE debt is excluded from the public debt statistics, as prescribed by the Law on Public Debt Management.	The closing time used for the whole year's public debt and state budget data is different. For public debt, it is from January 1 to December 31 every year. Meanwhile, for the budget year, the time lasts from January 1 of this year to January 31 of the following year.	The newly revised State Budget Law better aligns the reporting of budget data with international standards, effective January 2017.
Money Supply and Credit Growth	Domestic credit data by currency denomination, i.e. LCY and FCY, has yet to be made available.	Monthly data is released on the SBV website with a lag of two to four months.	-	-	-
Financial Sector Soundness Indicators	-	Monthly data is released on the SBV website with a lag of two to six months.	-	The implementation of a new loan classification, in accordance with SBV Circular 02 dated 2013, has enhanced the consistency of NPL data since mid-2016.	Officially reported NPL data may not capture the full picture of NPLs in the banking sector. Data on NPL acquisition and disposition by the Vietnam Asset Management Corporation should be included in an assessment on credit quality.
SOE Statistics	SOE statistics, including financial performance, divestment, and equitization progress, have yet to be made available on a frequent basis.	-	-	-	-

Notes:

- (i) Data availability refers to whether official data is available for public access by any means.
- (ii) Reporting frequency refers to the time interval with which available data is published. Timeliness refers to how up to date the published data is 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 the same or different categories.
- (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. This preliminary assessment will form the "Supplementary Data Adequacy Assessment" in the EPRD Matrix.

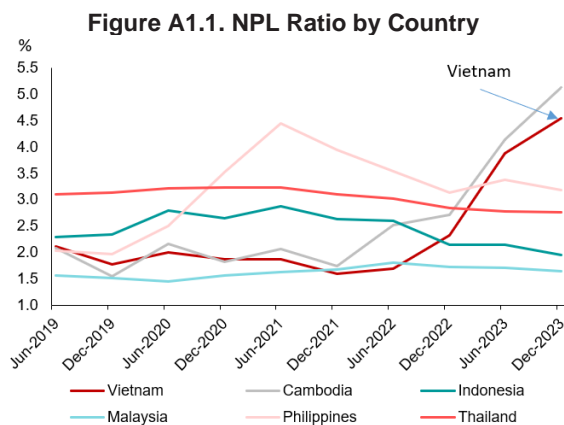
Annexes: Selected Issues

1. Whether Vietnamese Banks Can Pass Credit Stress Test ⁶⁵

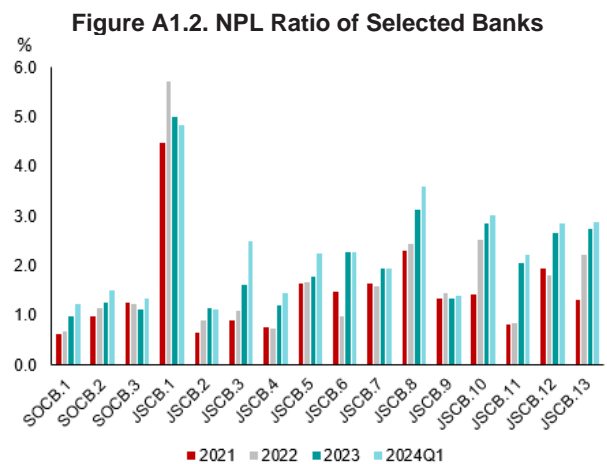
Vietnam is among the ASEAN countries with the highest non-performing loan (NPL) ratio in 2023. Weakened economic conditions and the real estate downturn contributed to the increase in the NPL ratio. If a tail-risk scenario of a prolonged real estate downturn happens, bad debts may increase significantly in the future. This Selected Issue aims to assess the resilience of the banking sector under such scenarios.

Deteriorating Asset Quality

1. NPL ratios have been increasing. NPL ratios in Vietnam have increased over the past two years, surging to levels significantly higher than in many other ASEAN countries (Figure A1.1). The NPL ratio reached 4.8 percent at the end of July 2024, compared to 2.2 percent at the end of 2022. Many individual banks have experienced significant increases in NPL ratios (Figure A1.2). This trend is largely attributed to weakened macroeconomic conditions and growing distress in key sectors, particularly real estate. Additionally, the NPL ratio is expected to increase further if more property developers become financially distressed. The expiration of loan moratoriums⁶⁶ by the end of 2024 may also lead to an increase in NPLs at some banks.⁶⁷



Source: Monetary Authorities; IMF via Haver Analytics



Source: FiinPro; AMRO staff calculations

2. Thin capital buffers will affect banks' ability to absorb losses as NPLs rise. Vietnam's capital adequacy ratio (CAR) is lower than in many regional peers, suggesting that its banking system may have less capacity to absorb future losses (Figure A1.3). Although banks can maintain CARs above the minimum regulatory requirement of 8 percent, some banks have CARs close to the minimum requirement level. In particular, state-owned commercial banks (SOCBs) have lower CARs than some joint-stock commercial banks (JSCBs)⁶⁸, making them more vulnerable to further asset quality deterioration. In response to weakening credit quality, banks have set aside larger amounts of loan loss provisions. As of Q4 2023, most listed banks have increased their provisions, with SOCBs and a few medium-sized JSCBs maintaining higher levels compared to other banks. (Figure A1.4).

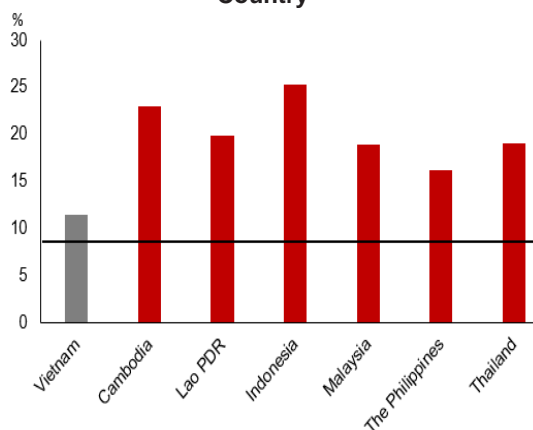
⁶⁵ Prepared by Trung Thanh Vu, Associate Economist, Dac Toan Nguyen, Associate

⁶⁶ The loan moratoriums were introduced in Circular 02/2023/TT-NHNN. On June 18, 2024, the SBV issued Circular 06/2024/TT-NHNN revising and supplementing Circular 02/2023/TT-NHNN, in which the SBV allows a six-month extension of Circular 02 until the end of 2024, instead of expiring on June 30, 2024.

⁶⁷ Total restructured loans under Circular 02/2023/TT-NHNN amounted VND114 trillion in July 2024, accounting for 0.5 percent of the total system outstanding loans.

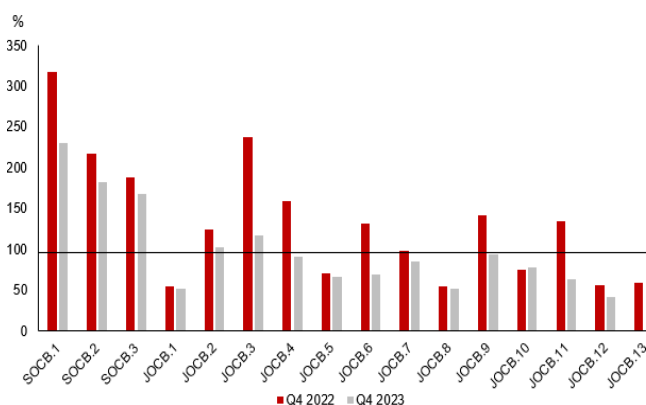
⁶⁸ The average CAR of SOCB was 10 percent while the average CAR of JSCBs was 12 percent at the end of 2023.

Figure A1.3. Average CAR of banks by Country



Source: IMF via Haver Analytics

Figure A1.4. Loan Loss Coverage Ratio



Source: SBV; AMRO staff calculations

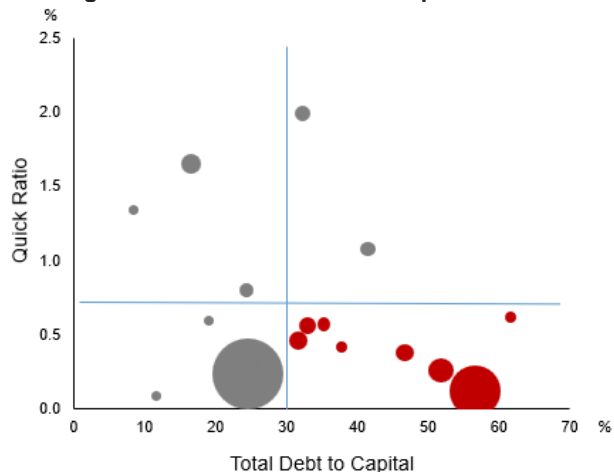
3. The real estate downturn poses risks to financial stability. Lending to real estate-related activity has expanded rapidly over the past several years, reaching over VND3,000 trillion by Q2 2024. As of July 2024, it accounts for 21 percent of total outstanding loans, of which lending to real estate developers is about 8 percent (Figure A1.5). Meanwhile, the NPL ratio associated with the real estate sector reached 3.7 percent in July 2024, compared to 2.8 percent at the end of 2023, reflecting the growing exposure of banks to the real estate sector and increasing financial pressures faced by real estate developers. Many large developers are heavily indebted and have a weak liquidity position, as reflected in low quick ratios⁶⁹ (Figure A1.6), signaling potential future defaults that could further strain the banking sector.

Figure A1.5. Lending to Real Estate



Source: SBV

Figure A1.6. Real Estate Developers' Debts



Source: Bloomberg

Note: The quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets. A quick ratio of lower than 1 can mean that the company is relying heavily on inventory or other assets to pay its short-term liabilities. The size of the bubble represents the relative asset size of a developer. The vertical and horizontal lines represent the sample average. Data are as of Q1 2024. Red bubbles represent those who have high debt to capital and low quick ratios.

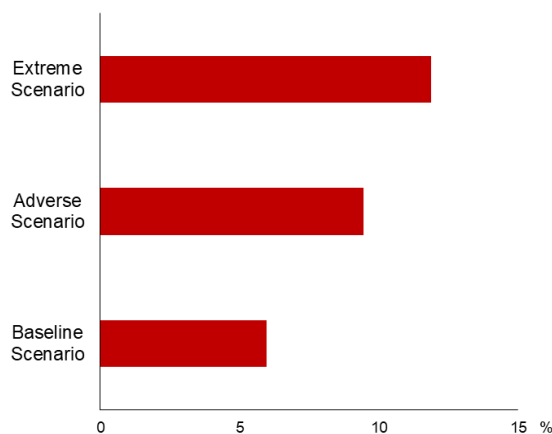
Banking Resilience: Pass the Stress Test?

⁶⁹ Furthermore, the financial conditions of real estate developers have deteriorated, with the interest coverage ratio declining steadily to 0.7 by the end of Q2 2024, down from 1.8 at the end of 2022.

4. Credit risk stress tests were conducted to assess the resilience of the banking sector. The stress tests covered 27 banks, which account for 73 percent of the total banking system. Two separate tests were conducted:

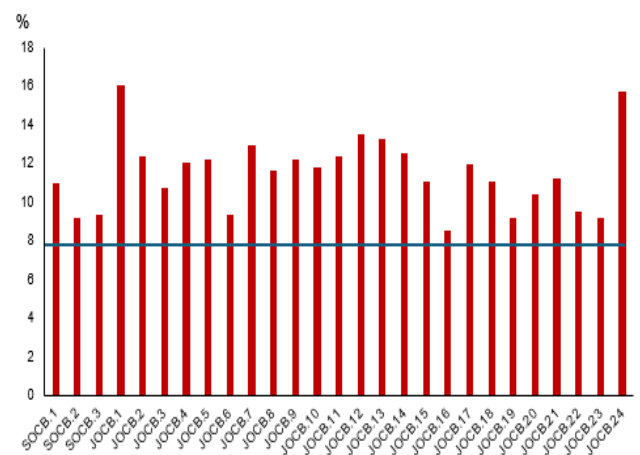
- *Sufficient provisioning against declining collateral values:* The first test evaluates whether banks have set aside enough provisions to absorb potential losses resulting from a situation where the full recovery of loan value is affected by declining collateral values. This test is crucial because, as collateral values decrease, the likelihood of covering the loan losses diminishes, increasing the need for adequate provisioning to safeguard against defaults. Two assumptions for this test are considered: one assumes a moderate decline (50 percent) in collateral values, and another assumes a more severe decline (75 percent).
- *Capital adequacy given increase in NPL ratio:* The second test focuses on whether banks' CAR remain above the regulatory minimum in the face of rising NPLs under three scenarios: baseline, adverse, and severe (Figure A1.7). The baseline scenario projects a recovery of the real estate sector, where the NPL ratio of the sector is projected to increase to 5.98 percent from the 4.7 percent observed in March 2024. The adverse scenario projects a prolonged real estate downturn, where the NPL ratio of the system is projected to increase to 9.44 percent. The severe scenario projects default in the real estate sector, where the NPL ratio of the system is projected to increase to 11.88 percent (Appendix A1.1). Among the three scenarios, the severe scenario is the tail-risk scenario least likely to happen, while a baseline scenario is most likely to happen based on current economic trends and conditions.
- The methodology employed for this test followed the approach outlined by Čihák (2014), along with a reverse stress test⁷⁰ (Appendix A1.1). Satellite models, particularly panel regression (Wezel, Canta, and Luy, 2011), were used to connect the macroeconomic variables to the financial variables, project the NPL ratio for the next period, and build up scenarios.

Figure A1.7. Projected NPL Ratios under Scenarios for Stress Test



Source: FinPro; AMRO staff estimates
Note: The increases of NPL in three scenarios are projected based on the estimated results of the panel regression (Appendix A.1.1).

Figure A1.8. CAR by Bank



Source: FinPro; Bloomberg; BankFocus
Note: The horizontal line represents the minimum requirement of 8 percent.

5. Most banks maintain sufficient provisioning rates for delinquency loans⁷¹ even after collaterals lose value. Under the assumed haircuts of 50 percent and 75 percent on

⁷⁰ The reverse stress test (RST) is based on the balance sheet-based approach, in which the balance sheet information of banks is the main data input. It estimates the breakeven NPL level of individual banks—the amount of NPLs that would reduce a bank's capital adequacy ratio (CAR) to the regulatory capital minimum, below which recapitalization would be necessary.

⁷¹ Delinquency loans refer to total loans that have payments overdue for more than 10 days.

collateral values, most banks, particularly large SOCBs, appear to have a sufficient level of provisioning⁷² (Table A1.1). Although SOCBs have lower capital buffers than other JSCBs (Figure A1.8), they set aside more loan loss provisions, which help them better withstand loan defaults. However, the test reveals that two JSCBs would be under-provisioned⁷³ in the event of 75 percent haircuts on collateral values, highlighting potential weaknesses in certain parts of the banking system.

Table A1.1. Result of the Stress Test on Provisioning Sufficiency

	Assumption 1	Assumption 2
Haircut on collateral	50%	75%
Number of banks that are under-provisioned	0	2
SOCBs	0	0
Medium-sized JSCBs	0	1
Small-sized JSCBs	0	1

Source: AMRO staff calculations

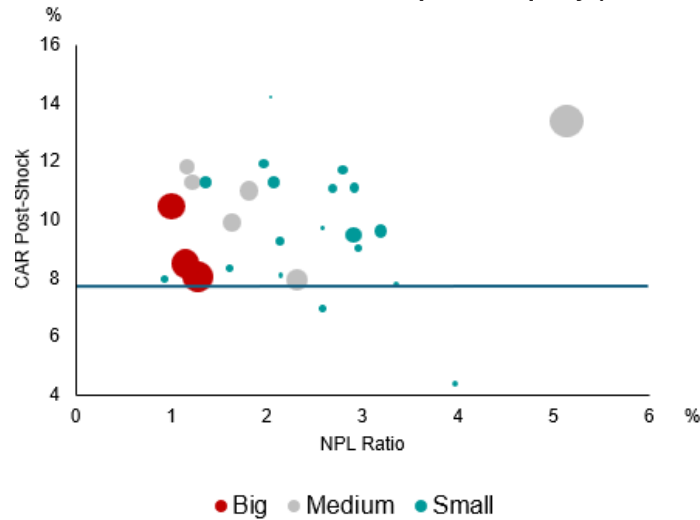
Note: Medium-sized JSCBs refer to those whose share is between 3 to 9 percent of the total system's assets. Small-size JSCBs refer to JSCBs whose share is smaller than 3 percent of the total system's assets.

6. Systemically important and medium-sized banks pass the capital adequacy stress test under adverse and severe scenarios. The adverse and severe scenarios project significant increases in NPL ratios across all banks. Although it is unlikely to happen, in a tail-risk severe scenario where the NPL ratio of the banking system increases to 11.88 percent, systemic important banks (large SOCBs) and medium-sized JSCBs are shown to maintain their post-shock CAR above the 8 percent regulatory minimum (Figure A1.9). Although they have relatively lower CARs, SOCBs demonstrate resilience in adverse and severe stress scenarios due to their ample loan loss provisions and low pre-shock NPL ratios. These provisions serve as an effective buffer, enabling SOCBs to withstand potential loan losses even when capital ratios are close to the regulatory threshold. However, not all banks demonstrate the same level of resilience. Two small-sized banks, accounting for about 1.3 percent of the total banking sector's assets, fail to pass the capital adequacy stress test under the severe scenario. Additionally, although some large SOCBs can pass the test, their post-shock CARs are closer to the regulatory threshold, indicating less shock-absorption capacity. This reflects potential vulnerabilities in their ability to weather prolonged or more severe economic crises, despite their systemic importance. Given their policy mandates, SOCBs may need to increase their CARs by retaining a larger portion of earnings.

⁷² The stress test applied provisioning rates as outlined in Decree 86/2024/ND-CP. For loans with payment overdue for less than 10 days, classified as pass loans, the provisioning rate is 0 percent. Special mention loans, with payment overdue for between 10 and 90 days, are provisioned at 5 percent. Substandard loans, spanning 91 to 180 days, require a 20 percent provision, while doubtful loans, with payments overdue for between 181 and 360 days, necessitate a 50 percent provision. Loans classified as loss loans, with payment overdue for more than 360 days, are provisioned at 100 percent.

⁷³ A bank is considered under-provisioned if, after a decline in collateral value, its CAR falls below the minimum regulatory requirement of 8 percent. This indicates that the bank has not set aside enough provisions to cover potential loan losses, leaving it vulnerable to further deterioration in asset quality.

Figure A1.9. Result of the Stress Test on Capital Adequacy (Severe Scenario)

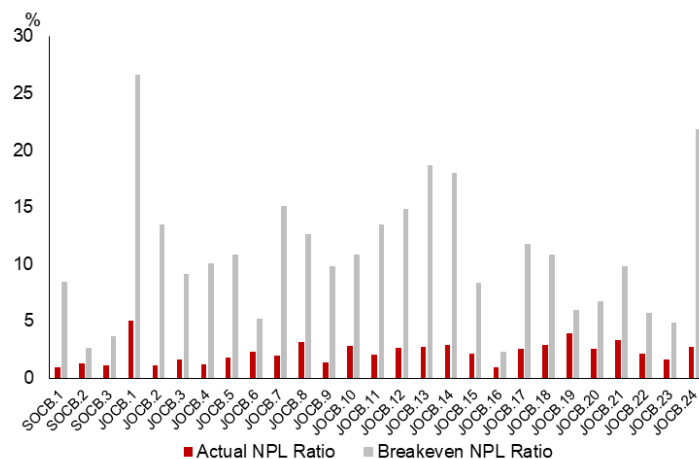


Source: FinPro; BankFocus; AMRO staff estimates

Note: Data are as of December 2023. Red dots refer to SOCBs whose share is larger than 9 percent of the total system's assets. Green dots refer to medium-sized JSCBs whose share is between 3 to 9 percent of the total system's assets. Grey dots refer to small-sized JSCBs whose share is smaller than 3 percent of the total system's assets.

7. The reverse stress test reveals uneven NPL breakeven across banks, suggesting differences in their resilience levels. While most medium-sized JSCBs are found to have relatively high breakeven NPL ratios, with some exceeding 15 percent, SOCBs and small-sized JSCBs have lower breakeven NPL ratios, generally under 10 percent (Figure A1.10). This means that most medium-sized JSCBs could tolerate significant increases in NPLs before their CARs dip below the regulatory minimum, reflecting their stronger capital buffers. In contrast, SOCBs display lower breakeven NPL ratios, withstanding only a small increase in NPLs, primarily due to their lower initial CARs. This finding aligns with the earlier stress test results, which indicated that SOCBs are more vulnerable to asset quality shocks due to their lower capital buffers. Therefore, the reverse stress also underscores that SOCBs and small-sized JSCBs may need to raise additional capital buffers to better protect against adverse economic conditions.

Figure A1.10. Breakeven NPL Ratios



Source: FinPro; BankFocus; AMRO staff estimates

Note: Data are as of December 2023. The JSCBs are organized in descending order based on their share of total system assets, with JSCB.1 being the largest, followed by JSCB.2, and so forth.

Policy Considerations

8. It is essential to strengthen capital buffers to ensure the resilience of banks in the face of rising NPLs. The results from both standard and reverse stress tests underscore the need for banks to maintain sufficient capital buffers to absorb potential losses. For domestic systemically important banks, additional capital requirements should be imposed to safeguard their soundness under adverse and severe conditions. One strategy to bolster capital buffers is to introduce higher-quality capital, such as Tier-1 capital, which can be achieved by retaining profits, reducing dividend payouts, and raising equity through public offerings. Furthermore, encouraging foreign strategic investment in local banks would not only provide necessary capital but also offer expertise in corporate governance, risk management, and innovation. These steps will help strengthen the banking sector's ability to withstand future shocks.

9. Implementing macroprudential policies and enhancing bad debt management system are crucial steps in maintaining financial stability. A robust macroprudential framework should be established to mitigate systemic risks, particularly those arising from the real estate sector. This framework should include measures like statutory loan-to-value ratios and debt service-to-income ratios to curb speculative demand and address imbalances in the real estate market. It is also essential to strengthen supervision to ensure commercial banks follow prudent lending practices, especially towards property developers, by imposing loan concentration limits. Close coordination between regulators and banking institutions is necessary to monitor systemic risks and enforce concentration limits in sectors showing signs of stress, such as real estate and construction. This will help safeguard the stability of the banking system. In addition, an effective debt management system is needed to address NPLs. The government can consider reinstating the right to seize assets, helping banks to resolve NPLs more efficiently.⁷⁴

Appendix A1.1. Panel Regression

A panel data regression is used to estimate the relationship between NPL ratios and selected macroeconomic variables and to project the NPL ratios for different scenarios. The model specification is based on the work done by Wezel, Canta, and Luy (2014)⁷⁵.

The models can be represented in the following form:

$$\ln\left(\frac{NPL_{i,t}}{1 - NPL_{i,t}}\right) = \mu + \alpha \ln\left(\frac{NPL_{i,t-1}}{1 - NPL_{i,t-1}}\right) + \delta loan_growth_{i,t} + \beta X_{j,t} + \varepsilon_{i,t}$$

where the dependent variable, NPL ratio, is transformed using the logit function, in which $\text{logit}(NPL_t) = \ln\left(\frac{NPL_t}{1 - NPL_t}\right)$. In addition to the logit-transformed NPL⁷⁶ for bank i in period t , the regression includes loan growth for bank i in period t , and $X_{j,t}$ represents explanatory variables, μ is the constant, and $\varepsilon_{i,t}$ is the idiosyncratic disturbance term assumed to be independent across banks and serially uncorrelated. Explanatory variables include GDP

⁷⁴ The new Law on Credit Institutions (No. 32/2024/QH15), approved in January 2024, strengthens the legal framework for bad debt management by incorporating provisions from Resolution 42/2017/NQ-QH14. However, the revised law excludes certain provisions in Resolution 42, such as the right to seize collateral, which could affect financial institutions' ability to manage bad debts effectively.

⁷⁵ We tried several estimations with different sets of variables for variable and model selection. The presented estimate results balance among various factors, including the availability of data, the model's performance and robustness, and Vietnam's characteristics.

⁷⁶ The logit transformation of the NPL ratio is commonly used in the literature to avoid the non-normality of the error term.

growth, lending rate, an interaction between probability of defaults (PD)⁷⁷ of listed corporates and a dummy variable for crises. Quarterly data cover the period from Q1 2019 to Q1 2024 of 23 commercial banks.⁷⁸

Estimate results are presented in Table A1.2.

Table A1.2. Panel Regression Results

Independent variables	Coefficients
Constant	-1.935*** (0.6713)
Logit NPL (-1)	0.5887*** (0.1727)
Loan Growth	0.0219** (0.0129)
Lending Rate	0.0468* (0.0310)
GDP Growth	- 0.0958*** (0.0271)
Dummy for Crisis	0.0834 (0.1340)
Crisis and Probability of Default	0.1388* (0.0890)

Source: FinPro; AMRO staff estimates

Note: *** represents p-value < 0.05, ** represents p-value < 0.1, * represents p-value < 0.15. R-squared is 0.5462. The lag of loan growth, probability of default, and its lag are used as instrumental variables in the regression. The Generalized Method of Moment is used to estimate the regression.

The projected results are derived using parameters generated from the adopted panel regression models, with input data based on each scenario's assumptions. Three scenarios are based on different assumptions (Table A1.3), including:

- **Baseline:** NPL ratios are projected to increase slightly but at a slow pace, with early signs of recovery in the real estate sector. This assumption aligns with the current situation, where the Vietnamese economy shows signs of recovery. Although developers are struggling with weak buyer demand, constrained credit availability, and delayed new project launches, three new real estate laws are expected to have positive impacts by addressing legal bottlenecks and boosting market sentiments. The recovery of the real estate sector is reflected by lower PDs of developers in the next period.
- **Adverse:** A prolonged downturn in the real estate sector is expected. This assumption accounts for the vulnerabilities in Vietnam's property market, where many developers are under financial strain, with delays in projects and rising inventories. If this persists, banks heavily exposed to real estate could face an increasing number of defaults, increasing the risk of financial instability. While some recent legislative reforms such

⁷⁷ The data for PD are from the Credit Research Initiative, National University of Singapore. Including interaction term is to focus on how crisis amplifies the NPL ratio. It's to capture the effect of PD on the NPL ratio during a crisis. The coefficient was used to build adverse and severe scenarios, where the dummy variable for crisis is equal to one and PD reaches its historical high. In a separate estimate, we also estimate a similar model specification but using all the PD, the dummy for crisis, and the interaction term, where the coefficient for PD was found to be statistically insignificant.

⁷⁸ Due to data limit, the panel data can only include 23 banks. For the stress test, data are available for 27 listed banks. The same system shocks are applied to all banks in the stress test.

as the revised Land Law, Housing Law, and Real Estate Business Law are set to take effect in 2025, their impacts will not be immediate. The prolonged downturn in the real estate sector is reflected by the continuously high PDs of developers.

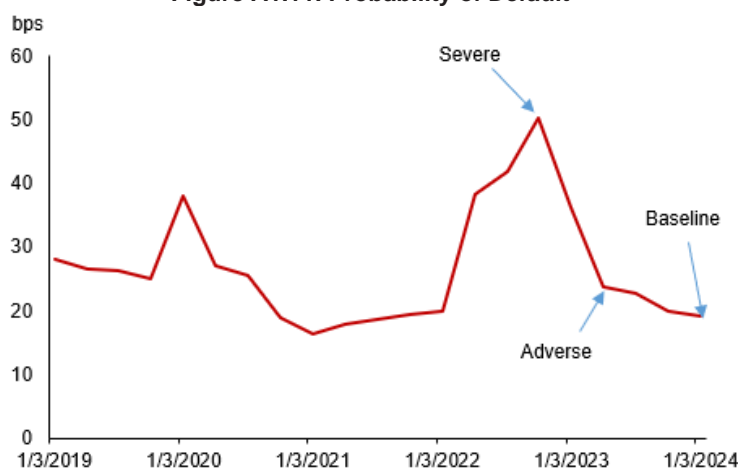
- Severe:** This scenario reflects more severe risks, where prolonged market stagnation leads to defaults in the real estate sector. Construction, closely tied to real estate, faces significant pressure due to reduced public investment flows and sluggish project completion rates. As bank exposure to these sectors remains high, a sharp rise in NPLs would amplify systemic risks. The PD of corporate sectors increases to their historical record under such stress, threatening the stability of the entire financial system.

Table A1.3. Assumptions for Scenarios

Scenarios	Assumptions
Baseline	GDP growth: 6.5 percent Lending Rate: 6.0 percent Loan Growth: 8.0 percent Probability of Default: 19 bps (Figure A.1.11)
Adverse	GDP growth: 6.0 percent Lending Rate: 8.0 percent Loan Growth: 10 percent Probability of Default: 22.8 bps (Figure A.1.11)
Severe	GDP growth: 4.0 percent Lending Rate: 9.0 percent Loan Growth: 12.0 percent ⁷⁹ Probability of Default: 50.29 bps (Figure A.1.11)

Source: AMRO staff estimates

Figure A1.11. Probability of Default



Source: Credit Research Institute, National University of Singapore

References

Cihak Martin (2014), “Stress Tester: A Toolkit for Bank-by-Bank Analysis with Accounting Data”, *Chapter 3, A Guide to IMF Stress Testing, International Monetary Fund, 2014.*

⁷⁹ On the one hand, loan growth is typically expected to be low during a severe scenario, reflecting weaker demand and heightened risk aversion. However, in Vietnam’s context, credit growth can still be higher during periods of low GDP growth. This is often driven by policy efforts to stimulate the economy, as seen in past instances. At the same time, banks may maintain high lending rates to safeguard profitability, despite increased risks of rising NPLs as enterprises may struggle to repay loans.

Wezel Torsten, Michel Canta, Manuel Luy (2014), "A Practical Example of the Nonperforming Loans Projection Approach to Stress Test", *Chapter 30, A Guide to IMF Stress Testing, International Monetary Fund, 2014.*

2. The Challenges of Carry-over Expenditures in Vietnam's Fiscal Management ⁸⁰

1. According to the State Budget Law, the government (both central and local) is permitted to carry-over expenditure that has not been implemented in the current fiscal year, to the following year. The purpose of government carry-over expenditure to subsequent years is to ensure sufficient state budget funds are available to continue incomplete or partially implemented expenditure tasks and assignments, without imposing additional pressure on the following year's budget ⁸¹. According to Vietnam's budget regulations, "carry-over expenditure" not only refers to undisbursed spending, but also includes the salary reform fund provision ⁸². However, information on the amount of carry-over expenditure only becomes available 18 months after the fiscal year ends, creating challenges in assessing the actual budget performance accurately and timely. Additionally, the detailed breakdown of carry-over items only become available starting in the 2022 final settlement.

Table A2.1. Carry-over Expenditure in Vietnam's Budget System (For example: 2022 Budget Performance)

Items	Original Budget	1st Estimate	2nd Estimate	Final Settlement (FS)
Revenue from the 2022 original budget	R	R ^{1st}	R ^{2nd}	R ^{FS}
Carried-over Revenue from previous year (2021)				Y
Expenditure	E	E ^{1st} = E ^a + E ^{co}	E ^{2nd} = E ^a + E ^{co}	E ^{FS} = E ^a + T + E ^{co}
- Actual expenditure from the 2022 budget		E ^a	E ^a	E ^a
- Carry-over expenditure from 2022 Budget to the following year (2023)		E ^{co}	E ^{co}	E ^{co}
- Carried-over expenditure from 2021 Budget that are disbursed in 2022				T
Fiscal Balance for 2022	R - E	R ^{1st} - E ^{1st}	R ^{2nd} - E ^{2nd}	(R ^{FS} + Y) - E ^{FS}

Source: Vietnam MOF, AMRO staff compilation

Note: This classification is used by the authorities in their budget performance reporting, which is different from AMRO's approach. In AMRO, the fiscal balance is calculated by $R^{FS} - (E^a + T)$, which is in line with the IMF Government Financial Statistics Manual.

2. In the original annual budget submitted to the National Assembly, the government sets the state revenue and expenditure without incorporating carry-over expenditure from the previous year that will be disbursed. The fiscal deficit is only based on the revenue and expenditures under the current year's budget. In October, the government announces the budget performance for the first 9 months of the ongoing fiscal year, including projections for the whole fiscal year (called the 1st estimate). Five months after the fiscal year ends, the government reports the preliminary assessment on last year's budget performance (called as the 2nd estimate) to the National Assembly. The budget performance in the first and second estimate excludes the disbursement of expenditure carried over from the previous year, but includes undisbursed expenditure that will potentially be carried over to the following year. Nevertheless, the final settlement of the budget performance (released by 18 months after the fiscal year ending) will include not only carried-over expenditure from the previous year, but also the expenditure carried -over to the following year. According to the State Budget Law, the same amount of carry-over expenditures from the previous year will be recorded as carried-over revenue in the following year's budget. The carried-over revenue

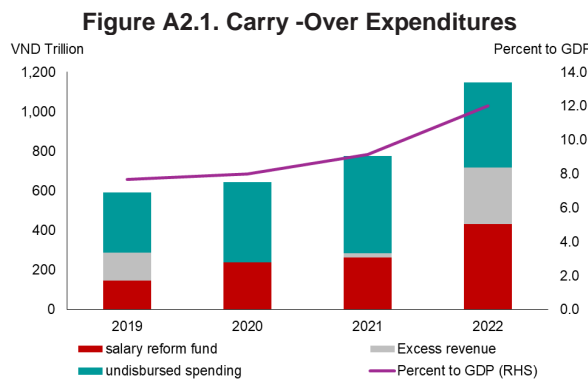
⁸⁰ Prepared by Ginanjar Wibowo, Fiscal Sector Specialist, and Tran Van Duc, Associate.

⁸¹ Not all the carried-over expenditure from the previous year is disbursed in the current year. The actual disbursement of expenditure that is carried over from the previous year is recorded as a part of the expenditure in the final settlement of the current year's budget, which is released 18 months of the fiscal year ending.

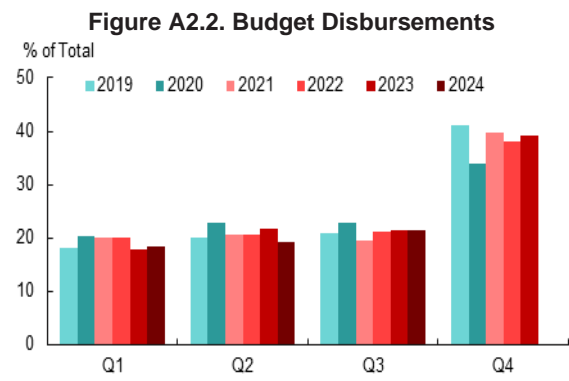
⁸² According to Article 64, Clause 3 and Clause 4 in the Law of State Budget, six types of expenditures are permitted to be carried over to subsequent years: incomplete development investment expenditure, equipment purchases with contracts signed before December 31, accumulated salary reform fund, undisbursed operational spending of public service and regulatory agencies, additional spending allocated after September 30, and expenditures related to Research and Development. The government has allocated portions of the budget (excess revenue and savings in the incremental of recurrent expenditure) towards the salary reform fund, which have been carried over to the following years to support the government officials' salary reform program in the future. Additionally, the rest of excess revenue will be carried over to the next year to be used for other purpose (such as new investment projects), subject to approval from the Standing Committee of National Assembly.

represents the additional cash available generated from the expenditure carried over from the previous year.

3. The carry-over expenditure has trended upward over the years, rising from 4.2 percent of GDP in 2013 to 12 percent in 2022. The expenditure carried over from 2022 to 2023 amounted to VND1,146.7 trillion (Figure A2.1), with the accumulated salary reform fund accounting for the largest share (38 percent), followed by undisbursed expenditure from the previous year. In the 2022 final settlement, the amount of capital expenditure carried over to 2023 reached 52 percent of the 2022 budget allocation.



Source: Vietnam MOF, AMRO staff estimation



Source: Vietnam MOF, AMRO staff estimation

4. The government's inability to execute the budget in a timely manner has driven the increasing trend of carry-over expenditure. Slow budget disbursement has been a significant challenge over the years. In the last three years, the actual execution rate for total expenditure has been less than 80 percent of the budget on average, with capital expenditure even worse at under 65 percent. At the end of September 2024, only 59.3 percent of total budget expenditure had been disbursed. Despite the 30 percent salary increase for public sector employees in July 2024, the total expenditure disbursement increased only by 1.4 percent compared to the same period a year earlier. Capital expenditure disbursement was particularly low at just 47.3 percent of the budget until the end of September 2024.⁸³ The disbursement of government spending is concentrated in the last quarter, excluding the undisbursed spendings that are carried-over to subsequent year (Figure A2.2). According to the State Budget Law, the budget for investment projects must be disbursed no later than January 31 of the following year. If not, it must either be cancelled or considered to be carried over to the next fiscal year.

5. Persistent structural challenges have hindered the progress of infrastructure development and thereby delayed the disbursement of capital expenditure over the years. First, infrastructure projects have often faced delays in site clearance due to differences of views over land price compensation. Contractors have also sought to wait for the implementation of the newly amended Land Law, enacted in August 2024, although the detailed decrees are still under development. This new law is expected to raise land price compensation, increasing the total investment amounts required for the projects. Second, the insufficient availability of raw materials⁸⁴ creates additional challenges in completing the projects. Third, executing agencies have not been proactive, especially as project guidelines can be interpreted

⁸³ Only 15 ministries and central agencies (of 44 ministries and central agencies) and 37 local governments (of 63 local governments) had capital expenditure disbursement rates above the national average. Some ministries disbursed less than 10 percent of their capital expenditure budget, such as the Ministry of Science and Technology, which saw disbursement rate of just 5.5 percent.

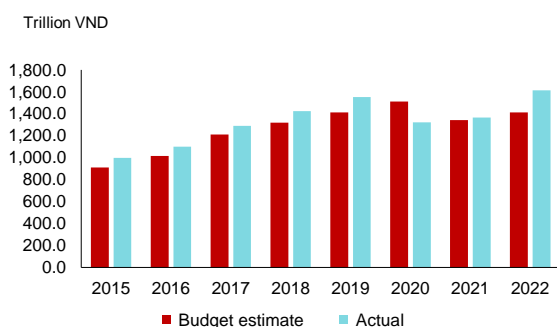
⁸⁴ This was not only during the Covid-19 pandemic, as the challenges have persisted until the time of writing. For example, since the Eastern Expressway project was started, a severe shortage of sand for roadbed construction in some provinces has significantly impacted the construction progress. Additionally, for some other projects, the increase in the prices of raw materials has led to difficulties in finding enough supply of materials, as the initial budget estimates have not been able to cover the price increases.

differently by stakeholders. Fourth, requirements associated with Official Development Assistance funding, including site clearance procedures, design appraisal, and bidding process, often create challenges in the implementation of externally funded projects. Lastly, the approval of the budget plan close to the start of the fiscal year has also contributed to project delays. Subordinate agencies and local authorities frequently need to adjust project budgets, postponing the selection of contractors and procurement. Although the State Budget Law permits capital expenditure to be carried over for only one year, in some special cases, it can be extended for multiple years upon approvals of the National Assembly⁸⁵.

6. The government has been accumulating funds for the salary reform fund to support policy measures related to salary adjustments for government officials. Since 2018, the government has committed to implement a comprehensive salary reform by establishing a new salary structure applicable universally to public officers. However, the implementation of a new salary structure has been delayed due to COVID-19, and it is still under discussion. In anticipation of the implementation of the salary reform, the government has established a salary reform fund, which is mainly funded from the accumulation of higher-than-budgeted revenue. The central and local government have to transfer 40 percent and 70 percent of the revenue that is higher-than-budgeted, to the salary reform fund. Additionally, if there is an increase in the budget allocation for recurrent expenditure as compared to the previous year’s budget (excluding salary and wage expenditure), both central and local government have to allocate 10 percent of the increase in budget allocation for the salary reform fund. The accumulated salary reform fund reached VND560 trillion by the end of 2023.⁸⁶ The 30 percent increase in the basic salary of public officials in 2024 has been financed both from the budget for 2024 and the salary reform fund.

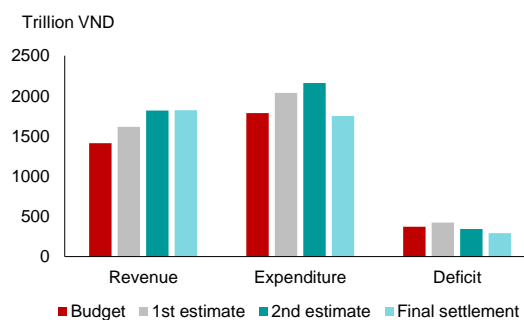
7. Revenue projections have consistently been underestimated, which has also contributed to the increasing carry-over expenditures. Since 2015, actual revenue has consistently exceeded budget estimates, for example, by 17 percent and 28 percent in 2021 and 2022 respectively. The only exception was in 2020, when actual revenue reached 98.1 percent of the budget target (Figure A2.3). As mandated by the State Budget Law, all the extra revenue is carried over to the following year for specific purposes, such as for the salary reform fund or for development projects⁸⁷.

Figure A2.3. Revenue performance



Source: Vietnam MOF, AMRO staff compilation

Figure A2.4. Discrepancy in 2022 Budget performance



Source: Vietnam MOF, AMRO staff compilation

⁸⁵ The extension of central government spending for more than one year must be approved by the National Assembly, as it is not currently stipulated in the State Budget Law.

⁸⁶ In July 2024, the government implemented the 30 percent increase in civil servants’ basic salary, requiring a budget of VND226 trillion; of which VND152 trillion was financed by the salary reform fund, while VND74 trillion came from the allocated 2024 budget.

⁸⁷ According to the State Budget Law, after the fiscal year ends, the government has to make a plan on the use of extra revenue and seek approval from the Standing Committee of National Assembly. The plan including on how much will be used for salary reform fund and other purposes (including for financing new investment projects). The Standing Committee will make a decision/approval and report it to the National Assembly (for information only).

8. Consistently rising carry-over expenditure each year could negatively impact the quality of budget planning. Information on actual carry-over expenditures is only available in the final settlement of the budget, released up to 18 months after a fiscal year ends. The final budget settlement often differs significantly from the preliminary assessments announced in the five months after the fiscal year ends. This delay and discrepancy create challenges in accurately assessing the fiscal stance, which makes it difficult for policymakers to conduct effective evaluations of the economic impact of government policies. Additionally, it results in the accumulation of large amounts of cash in the state treasury that remain undisbursed but could have been used for development of the economy. This reduces the efficiency of public resources.

9. The government needs to address carry-over expenditure, particularly that resulting from inefficient execution of budget spending. The disbursement of budget allocation can be improved by ensuring that multi-year budget allocations for infrastructure projects are implemented according to schedule. Public investment projects should be implemented according to planned timelines to reduce carry-over capital expenditure.⁸⁸ Moreover, improving the accuracy of revenue forecasting is also necessary⁸⁹. Strengthening coordination among relevant stakeholders is crucial, especially in fostering a shared commitment to infrastructure development.⁹⁰ The government should also enhance supervision and consultation mechanisms, as well as provide clearer guidance to subordinate agencies to quickly resolve challenges. Shortening the final budget settlement period can contribute significantly to better budget evaluation and planning as well. Lastly, the government should implement comprehensive salary reform in a timely manner.

⁸⁸ This effort can be done by strictly monitoring on the disbursement progress of each project. Additionally, urgent implementation of the new Land Law to address bottlenecks in site clearance and land acquisition could help to accelerate the progress of investment project construction

⁸⁹ Minimizing the deviation between the estimated and actual revenue can reduce the carry-over expenditure because the excess revenue will be a part of the carry-over expenditure to the following year, according to the State Budget Law.

⁹⁰ On September 2024, the government has established 7 Working Groups aims to expedite annual budget disbursement of public investment projects both in central and local government levels. It is strictly important to ensure the effectiveness of this WGs on addressing structural challenges hindering slow disbursement in public investment project.

3. Trade Finance in Vietnam: Supporting Growth for MSMEs⁹¹

1. Access to finance constitutes a major hurdle for many MSMEs, despite their prominent role in Vietnam’s economy. MSMEs account for around 98 percent of all registered enterprises and employ around 70 percent of the country’s workforce.^{92, 93} However, many MSMEs face difficulties in securing funding; only about 30 percent have access to bank credit, and about a quarter consider financial access the main obstacle in their business operations.⁹⁴

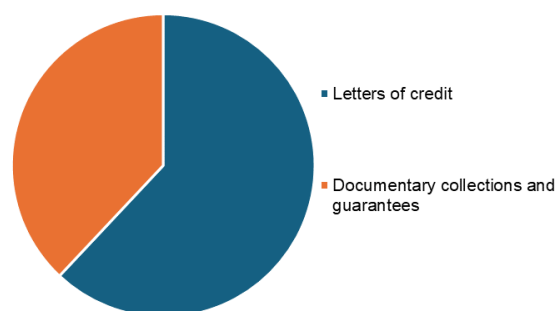
2. For MSMEs involved in international trade, financial access can be enhanced through greater usage of trade finance, a term that encompasses a variety of financial instruments used to facilitate payments between exporters and importers (Figure A3.1). In Vietnam, domestic enterprises tend to have greater demand for trade finance than foreign enterprises, as the latter can normally rely on financing from parent companies and foreign banks. Among domestic enterprises, trade finance is used more by large enterprises than by MSMEs, whose demand for trade finance is not adequately met. It has been estimated that if the share of trade covered by trade finance is increased by 20 percentage points and trade financing cost is reduced to advanced economy levels, Vietnam’s imports and exports can be increased by 6 percent and 9 percent, respectively.⁹⁵

Figure A3.1. Common Trade Finance Instruments

Aspect	Instrument
Payment methods	<ul style="list-style-type: none"> • Letters of credit • Documentary collections • Open account payments
Guarantees	<ul style="list-style-type: none"> • Payment guarantees and stand-by letters of credit • Bid bonds and performance bonds
Loans	<ul style="list-style-type: none"> • Pre-export finance • Post-shipment/import finance
Supply chain finance	<ul style="list-style-type: none"> • Supplier finance • Factoring

Source: WTO and IFC (2024)

Figure A3.2. Bank-Intermediated Trade Finance Transactions (Value)



Source: WTO and IFC (2024), AMRO staff calculations.

3. Trade finance instruments used in Vietnam are mostly provided by banks, such as letters of credit (LC), documentary collections, and guarantees. While there are several types of trade finance instruments that address various aspects of cross-border trade—ranging from payment methods and guarantees to supply chain finance—and are generally offered by different types of financial institutions, most trade finance in Vietnam is provided by banks. As of 2022, Vietnam’s trade finance transactions in banks amounted to USD82.5 billion, or around 11.4 percent of total trade.⁹⁶ About 62 percent of these transactions were in the form of LC—according to SWIFT, the global company that provides financial messaging services, usage of LC in Vietnam appears to be in line with the country’s trade

⁹¹ Prepared by Jade Vichyanond, Economist.

⁹² ADB (2023). *2023 ADB Asia SME Monitor - Viet Nam*.

⁹³ Ministry of Information and Communication, quoted in Viet Nam News (2023). *SMEs development fund plans further reduced interest rates*.

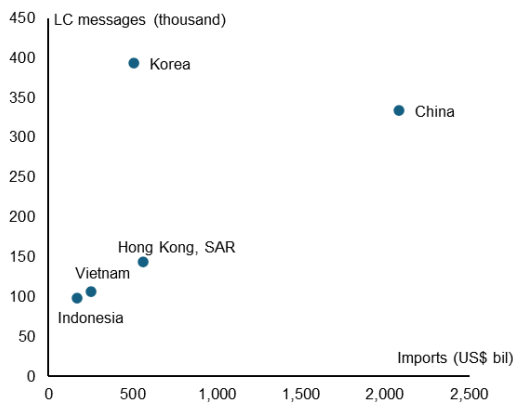
⁹⁴ OECD (2021). *SME and Entrepreneurship Policy in Viet Nam*.

⁹⁵ WTO and IFC (2024). *Trade Finance in the Mekong Region*.

⁹⁶ Ibid. Export financing in the forms of working capital and other loans is not included as it is sometimes difficult to distinguish it from non-trade-finance loans.

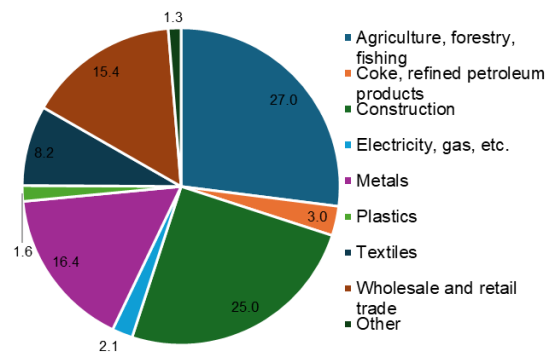
volume (Figures A3.2 and A3.3).⁹⁷ Documentary collections and guarantees constituted the remaining 38 percent of the banks’ trade finance transactions.

Figure A3.3. SWIFT LC Messages



Source: International Chamber of Commerce (2020), SWIFT, AMRO staff calculations.

Figure A3.4. Trade Finance Usage by Sector

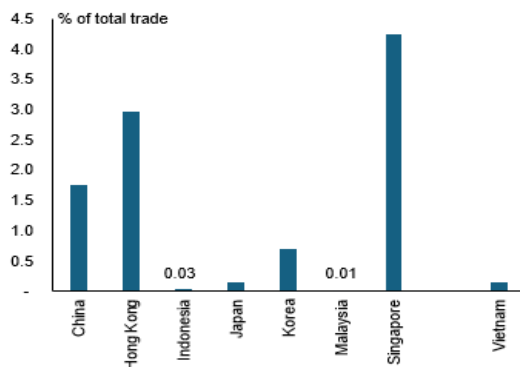


Source: WTO and IFC (2024), AMRO staff calculations.

4. Trade finance instruments intermediated by banks in Vietnam are mostly used in the agriculture/forestry/fishing, construction, and metals sectors (Figure A3.4). This can be attributed to the fact that these sectors consist largely of locally owned companies, some of which may not have sufficient internal funds for export and import activities. Meanwhile, usage of bank-intermediated trade finance instruments by the electronics and textile/garment sectors, which command substantial shares of Vietnam’s exports, is minimal, as these sectors are dominated by foreign companies, which can rely more on intra-firm financial support and syndicated arrangements with international banks.

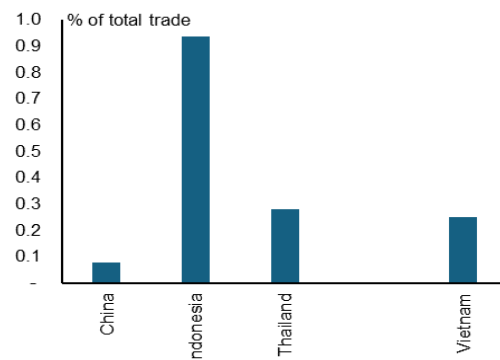
5. Factoring and trade insurance are some of the non-bank-intermediated trade finance instruments used in Vietnam. Factoring, a type of invoice purchase whereby a seller of goods/services (exporter) sells an invoice at a discount to a finance provider (“factor”), who then collects the payment, is also used by some companies in Vietnam, although the amount is relatively low, at USD1.1 billion, or 0.15 percent of total trade, in 2022 (Figure A3.5). Similarly, there is limited usage of trade insurance, such as export credit insurance and political risk insurance, in Vietnam; political risk insurance amounted to USD1.6 billion, or 0.25 percent of total trade, in 2022 (Figure A3.6).

Figure A3.5. Factoring



Source: Factors Chain International (2022), AMRO staff calculations

Figure A3.6. Political Risk Insurance



Source: Berne Union (2022), AMRO staff calculations

⁹⁷ About 90 percent of global LC transactions go through SWIFT.

6. Some of the key challenges MSMEs face in accessing trade finance are high collateral requirements and insufficient documentation. On average, domestic companies need to have collateral worth at least 90 percent of the financing need, compared to less than 10 percent for foreign companies.⁹⁸ At the sectoral level, collateral requirements for the low-tech manufacturing and wholesale/retail trade sectors, both of which are the domain of MSMEs, are on average around 60 percent and 95 percent, respectively while those for high-tech manufacturing companies are less than 10 percent on average. Besides lack of collateral, insufficient documentation is often cited as one of the key reasons behind trade finance application rejections in Vietnam. Despite both paper and online filing being legally accepted for most trade finance instruments, most applications are filed on paper and sometimes incomplete, resulting in rejections.⁹⁹

7. On the supply side, trade finance usage in Vietnam is constrained by banks' customer limits, limited correspondent bank relationships, and relatively high costs of trade finance products. First, according to the current regulation, trade finance products are treated similarly to other products in the calculation of banks' customer limits, despite the difference in the risk profiles and other product characteristics. As a result, it can be challenging for a company to access trade finance if it has almost reached its bank's limit due to substantial usage of, say, working capital loans.¹⁰⁰ Second, lack of correspondent bank relationships on the part of local banks sometimes prevents them from providing trade finance. Some of the main constraints for local banks' ability to establish correspondent bank relationships with overseas banks are increased regulatory requirements related to anti-money laundering and counter-terrorist financing (AML/CFT) and insufficient line limits. Lastly, trade finance products in Vietnam tend to be more expensive than in other countries. The average fee for LCs in Vietnam is 3.25 percent of the transaction value, compared to the average of 2 percent for emerging markets.¹⁰¹

8. Looking ahead, in order to deepen the trade finance market in Vietnam, concerted efforts by relevant parties are vital. For banks, enhancement in the process of evaluating financing requests may help them better understand MSMEs' needs and risks and thus lower the amount of required collateral. On the part of the authorities, establishing a separate agency to help MSMEs develop business plans and prepare financial statements, such as Korea's Ministry of SMEs and Startups, can help facilitate the approval process. From a regulatory perspective, adjustments to banks' customer limits may be considered with a view to easing the rules on credit extensions for trade finance products. Lastly, it is important that the authorities and the financial sector promote awareness among the business community, particularly smaller companies, of the various types of trade finance products available, as greater awareness and interest could help increase the number and diversity of trade finance providers and lower the costs of trade finance going forward.

⁹⁸ WTO and IFC (2024). *Trade Finance in the Mekong Region*.

⁹⁹ International Chamber of Commerce (2020). *2020 ICC Global Survey on Trade Finance*.

¹⁰⁰ Hanoi Times (2024). *Enhanced local trade finance in Vietnam: A potential US\$55 billion annual trade boost*.

¹⁰¹ WTO and IFC (2024). *Trade Finance in the Mekong Region*.

4. Ensuring the Sustainability of Vietnam's Public Pension Fund through Asset Diversification¹⁰²

1. Vietnam's rapidly aging population has resulted in concerns about the long-term sustainability of the country's public pension fund. Vietnam is projected to become an aged society by 2036, heightening worries about the swift rise in social insurance spending and the potential depletion of the social insurance fund (SIF)¹⁰³ managed by Vietnam Social Security (VSS). To safeguard the long-term sustainability of the fund, the Vietnamese government has amended the social insurance law, which will come into effect on July 1, 2025. Key changes comprise including voluntary social contribution system from informal workers,¹⁰⁴ broadening the definition of eligible participants in compulsory schemes¹⁰⁵, and introducing new payout schemes¹⁰⁶ commensurate with the duration of social insurance contributions. These measures aim to extend social security coverage and ease pressure on fund outflows. Additionally, for the first time, the new law permits the social insurance fund to diversify its investment portfolio by expanding into foreign government bonds¹⁰⁷. Despite the passage of the new law, the implementation remains uncertain as the subordinate regulations are still being drafted. This selected issue evaluates the net income of the SIF in two scenarios: baseline scenario in which current contribution and payment schemes remain unchanged, and alternative scenario incorporating the social security reform. It also explores the diversification of public SIF investment portfolios in other countries as potential policy options for VSS.

Long-term Sustainability of VSS's SIF

2. The income-expenditure balance of the VSS remains in surplus, thanks to social security reforms and a population structure dominated by young citizens. The Vietnamese government announced the reforms in 2018 with the goals of expanding social insurance coverage (Table A4.1), and enhancing the capacity, effectiveness, and efficiency of public social insurance management. As part of the reform, the retirement age was increased to 65 for men and 62 for women. The replacement rate was also reduced from 75 percent of the reference salary to 45 percent for the first 15 years of contributions. However, the accrual rate for contributions beyond 15 years was set at 3 percent per year for women and 2 percent

¹⁰² Prepared by Wanwisa May Vorrnikulkij, Senior Economist.

¹⁰³ According to Vietnam's 2024 Social Insurance Law, the social insurance system includes two schemes: a compulsory scheme and a voluntary scheme, with the latter expanded benefits in the law. The compulsory social insurance scheme covers benefits including sickness, maternity, occupational diseases, work-related accidents, retirement, and death. On the other hand, the voluntary social insurance scheme offers benefits for sickness, a one-time maternity allowance, work-related accidents, retirement, and death, —an expansion from the previous 2014 law, which only covered retirement and survivorship allowances.

¹⁰⁴ According to (International Labour Organization, 2015), informal employment is defined as "all remunerative work (i.e. both self-employment and wage employment) that is not registered, regulated or protected by existing legal or regulatory frameworks, as well as non-remunerative work undertaken in an income-producing enterprise. Informal workers do not have secure employment contracts, workers' benefits, social protection or workers' representation."

¹⁰⁵ The 2024 law broadens the definition of employees subject to compulsory social insurance to include the following groups:

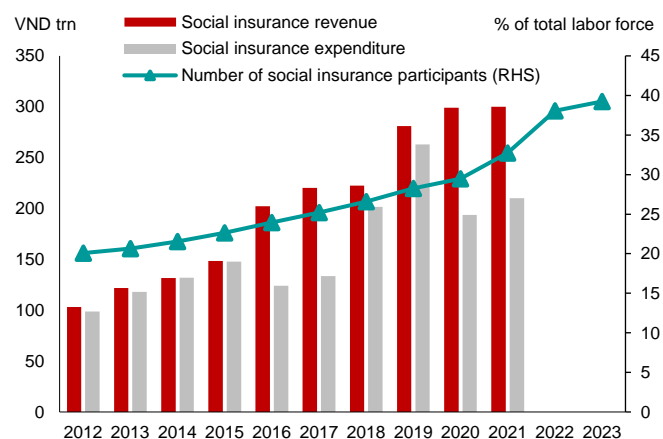
- 1) Workers under indefinite-term or fixed-term employment contracts with a duration of one month or more. This includes cases where the employee and employer agree in writing to use a different title for the contract (as opposed to just "labor contract" under the 2014 law) that still involves paid employment, salary, and the management, administration, and supervision of one party;
- 2) Vietnamese citizens, including enterprise managers, supervisors, representatives of state capital or enterprise capital, members of the Board of Directors, General Directors, Directors, Supervisory Board members, or supervisors who do not receive salaries, as well as part-time employees whose monthly earnings are equal to or higher than the minimum salary used as the basis for compulsory social insurance contributions; and
- 3) Employees in their first month of employment or returning to work after a sick leave of 14 or more days.

¹⁰⁶ The 2024 law reduces the required contribution period for compulsory social insurance from 20 years to 15 years. For individuals contributing for 15 years, the monthly pension will be 40 percent of their average salary used as the base salary for social insurance payment, compared to 45 percent for those contributing for 20 years. Each additional year of contribution beyond 15 years will increase the pension replacement rate by 1 percent. Furthermore, the lump-sum payment has been reduced to 50 percent of the total contributions, down from the full amount previously provided.

¹⁰⁷ Article 122 of the 2024 Social Insurance Law permits the Vietnam Social Security (VSS) to invest in overseas assets. However, the VSS cannot proceed with such investments until subordinate regulations, that would outlining eligible investment schemes and risk management practices and have not been drafted, come into effect.

per year for men. Since the implementation of the 2018 reforms, the VSS has actively encouraged Vietnamese workers to participate in the pension fund. By 2023, the number of social insurance participants had reached 18.3 million, equivalent to 39.3 percent of the labor force, up from 25.2 percent in 2017 (Vietnam Social Security, 2023) (Figure A4.1). While the number of pension contributors has increased, boosting VSS's revenue, the amount of pension payments remains low, as the number of monthly pension and social insurance beneficiaries was about 3.3 million people, equivalent to 12.6 percent of the senior population older than retirement ages.

Figure A4.1. Financial Balance of VSS's Social Insurance



Source: VSS; Haver Analytics; AMRO staff calculations

Table A4.1. Pension-related Goals of the Social Insurance Reform

Milestone	Targeted Share of Labor Force Participating in SI [% of Total Labor Force]	Targeted Share of Farmers and Informal Sector Participating in Voluntary SI [% of Total Labor Force]	Targeted Share of Retirees Receiving Pension Benefits [% of Population Older Than Retirement Ages]
2021	35%	1.0%	45%
2025	45%	2.5%	55%
2030	60%	5.0%	60%

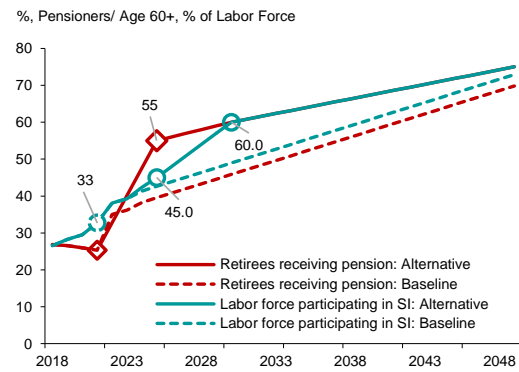
Source: The Central Committee of the Communist Party of Vietnam (Resolution No.28-NQ/TW, May 23, 2018)

3. We conducted a simulation exercise to assess the impact of social security reform on the VSS's net income flows. Ideally, evaluating the long-term sustainability of a pension fund should include not only net revenue but also interim fund flows and investment earnings. However, due to the lack of data on VSS's investment activities, the simulation focuses solely on pension contributions and payments (Box A3. Simulation Exercise on VSS' Financial Balance). This exercise, previously conducted in 2018, aims to re-estimate the net revenue of VSS's SIF of two scenarios: baseline scenario assuming status quo, and alternative scenario incorporating the social security reform. The net income is projected up to 2049, based on publicly available data from 2012 to 2021 and the United Nations' population projections for 2022. The simulation includes two scenarios (Figure A4.2).

- **Baseline scenario:** regarding pension contributions, the number of social insurance participants is assumed to grow at the same pace as it did before 2018, that is without the social security reform. The contribution per worker increases at the rate of the GDP deflator. On the pension payment side, the number of beneficiaries is assumed to rise in line with the growing senior population and the number of pension participants. Payments per pensioner would also increase at the rate of the GDP deflator.

- Alternative scenario:** the number of social insurance participants and pension beneficiaries is assumed to grow at a higher pace in line with the broader coverage set by the social security reform. SI contributions are projected to grow at the same rate as the GDP deflator, with an additional annual increase from 2024 onwards, reflecting the expanding coverage of SI schemes. Meanwhile, benefit payments are expected to gradually decrease, reflecting a decline in the number of beneficiaries eligible for the 75 percent replacement rate.¹⁰⁸ With the replacement rate reduced from 75 percent to 45 percent, the total payment will progressively decrease to reflect the growing proportion of pensioners entitled to the smaller replacement rate.

Figure A4.2. Social Insurance Participants and Pension Beneficiaries



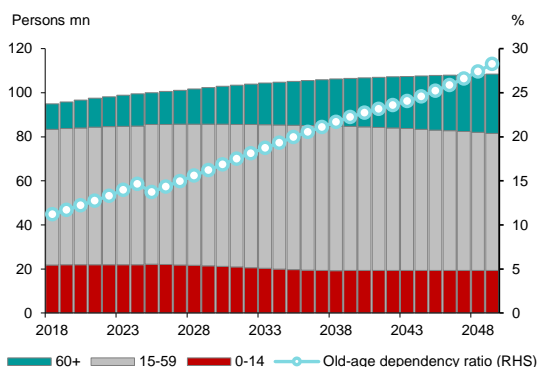
Source: VSS; Haver Analytics; AMRO staff calculations

4. Despite the social security reforms, a rapidly aging population could undermine the sustainability of the social insurance fund in the next decade. Baseline scenario results show that the income-expenditure balance of the social insurance account could fall into deficit by 2032. This is due to the aging population (Figure A4.3) and generous pension payouts driving social insurance expenditures to grow much faster than contributions. The alternative scenario suggests that even the expansion of social insurance coverage and reduction in pension payments would not be sufficient to offset the impacts of an aging population in the long run. The reforms could only delay the deficit until 2035, one year before Vietnam becomes an aged society (Figure A4.4). Additionally, due to data limitations, this exercise cannot account for the impacts of ongoing lump-sum withdrawals before the Amended Law on Social Insurance takes effect in 2025. These withdrawals could further reduce the net revenue estimated by this simulation.

5. The new social insurance law could alleviate the pressures on the SIF's sustainability. The new law aims to ensure adequate post-retirement incomes for Vietnamese workers and the sustainability of the VSS. Major amendments include broadening the coverage of compulsory social insurance to self-employed workers, contract workers, and workers in the informal sectors; introducing basic social benefits for seniors aged 80 and above who have not received any pension or monthly social insurance benefits; shortening the contribution period for pension entitlement to allow more middle-aged workers to qualify for pensions; and prohibiting the lump-sum payout for new contributors (Nguyen, Khuat, & Pham, 2023). Expanding the pool of contributors could increase inflows to the SIF, while tightening regulations on lump-sum withdrawals could reduce the risk of sudden fund depletion. However, demographic changes in the next decade will still pose challenges to the fund's sustainability.

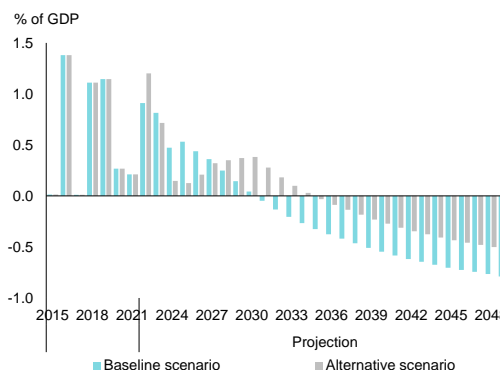
¹⁰⁸ Beneficiaries who were already receiving 75 percent of the reference salary after meeting the minimum contribution years are grandfathered under the previous system. Subsequent cohorts will receive 45 percent of the reference salary for the first 15 years of contributions. To promote retirement savings, the accrual rate for contributions beyond 15 years was set at 3 percent per year for women and 2 percent per year for men, until the replacement rate reaches 75 percent.

Figure A4.3. Demographic Structure



Source: VSS; Haver Analytics

Figure A4.4. Net Annual Contribution of VSS's Social Insurance



Source: VSS; Haver Analytics; AMRO staff calculations

Box A4. Simulation Exercise on VSS's Financial Balance

Vietnam commenced its social security reform in May 2018. It represented a comprehensive revamp of social policy, including pension. Considering rapid population ageing and the policy reform, AMRO conducted a simulation exercise to assess the implications of the changes in pension schemes on the long-term sustainability of Vietnam's SIF (ASEAN+3 Macroeconomic Research Office, 2019).

The simulation exercise estimates the potential impact of several policy options on the income-expenditure balance of the VSS's SIF. Net annual SI revenue (NR_t) is calculated based on the difference between total SI revenue (TR_t) and total SI expenditure (TE_t). We decompose revenue and expenditure into unit price and quantity terms:

$$NR_t = TR_t - TE_t$$

$$= (contr_t * insurer_t) + (ben_t * pensioner_t)$$

where total revenue is separated into the SI contribution per SI insurer ($contr_t$) and the number of SI insurers ($insurer_t$). Total expenditure is factored into benefit payout per each beneficiary (ben_t) and the number of SI beneficiaries, representing pensioners, ($pensioner_t$).

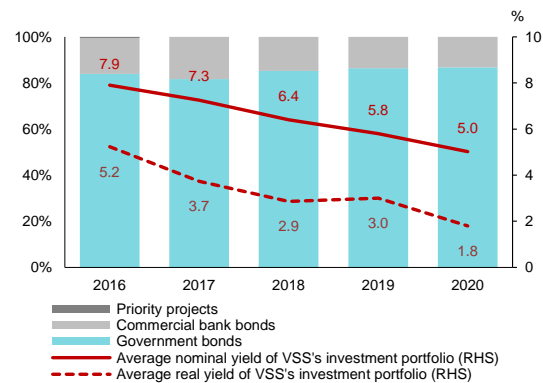
Caveats and data limitations

- Ideally, the assessment of long-term sustainability of a pension fund is meant to focus on not only net revenue but also interim fund flows and investment earnings. However, due to lack of data on VSS's investment activities, the simulation focuses on social insurance contribution and payments only.
- Vietnam's social insurance fund covers benefits for retirement, survivorship, sickness, maternity, as well as occupational accident and disease. As there is no segregated data on revenue and expenditure pertaining to specific benefits, this exercise uses total SI revenue and expenditure as a proxy for pension contributions and payments.
- Due to data limitations, the simulation does not include lump-sum withdrawals from the social insurance fund.

Increasing Investment Income as an Alternative Policy Option

6. Declining investment returns have suppressed the net revenue of the VSS too. Generally, there are four major policy options to strengthen the pension reserve fund and its financial sustainability: increasing contributions, broadening coverage, reducing benefit payments and/or replacement rates, and increasing investment returns. Although the average yield on the VSS's investment portfolio has declined over time in a low-interest-rate environment, the portfolio investments, under the current regulations¹⁰⁹, remain mostly unchanged (Figure A4.5). The current regulations governing investment activities of public social insurance, health insurance, and unemployment insurance funds (Decree No. 30/2016/ND-CP) have been in place since 2016. The VSS can invest the funds only in: (i) Vietnamese government bonds; (ii) lending to the State budget; (iii) deposits, bonds, promissory notes, bills, and certificates of deposit issued by commercial banks with a good credit rating from the State Bank of Vietnam; (iv) government-guaranteed bonds issued by the Vietnam Development Bank and the Bank for Social Policies; and (v) investments in important projects as decided by the Prime Minister. In response to declining investment returns, the new social insurance law permits the VSS to invest its SIF in foreign government bonds, either through self-managed investments or through entrusted fund managers. More detailed investment guidelines will be outlined in forthcoming regulations.

Figure A4.5. VSS' Portfolio Investment and Yield



Source: VSS; GSO; AMRO staff calculation

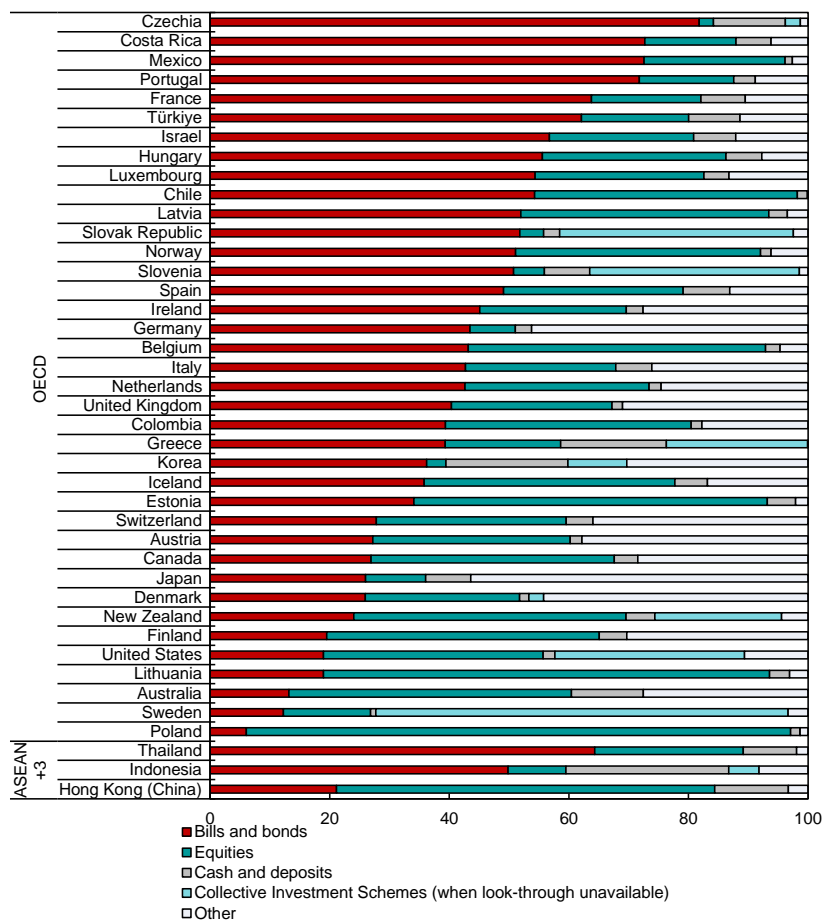
7. Diversifying the asset structure of a pension fund could enhance long-term returns and mitigate risks associated with prolonged investments. Pension funds have traditionally primarily invested in public fixed-income products due to their lower-risk nature. However, given the extended period of low yields and heightened inflation, alongside rapid demographic aging dynamics, fixed income investments may struggle to meet the long-term liabilities of a pension fund. While fixed income investments offer lower risk and less volatile returns, equity investments have the advantage of outperforming long-term inflation-linked bonds (Scott, 1991). A pension fund's assets should also include other investments, such as deposits or alternative investments, to manage risks arising from market fluctuations in equities and fixed income. This diversification can help mitigate the potential for lower returns caused by high negative correlations between traditional stocks and bonds (PWC, 2016). Additionally, pension funds could benefit from international diversification for instance, increasing foreign holdings could potentially boost investment yields for public pension funds in Brazil, Thailand, and Indonesia by 0.22, 0.15, and 0.14 percentage points, respectively (Afanador, Davis, & Pedraza, 2021).

8. Since the Global Financial Crisis in 2008, pension funds in many countries have been increased their allocation to non-fixed income investments. Factors such as an aging population, sluggish economic growth, and persistently low interest rates have compelled public pension funds to diversify their investment portfolios in the pursuit of higher returns. According to a PWC survey on the investment strategies of global pension funds (PWC, 2016), pension funds, especially in advanced economies, have gradually been

¹⁰⁹ Social Insurance Law No. 58/2014/QH13 and Decree No. 30/2016/ND-CP

reallocating their assets towards equities and alternative investments. The share of alternatives such as real estate in all pension fund portfolios increased from 19 percent in 2009 to 26 percent in 2014, while the share of fixed income instruments declined from 38 percent to 28 percent during the same period. By 2021, all public pension funds in OECD countries and some selected ASEAN+3 economies had investments in equities (Figure A4.6), with a growing number of funds turning to alternative asset classes. Although pension funds in Asia tend to be more conservative compared to those in developed markets, they have been gradually increasing their long-term investments in illiquid assets such as private equity, real estate, and infrastructure (Association of the Luxembourg Fund Industry, 2020).

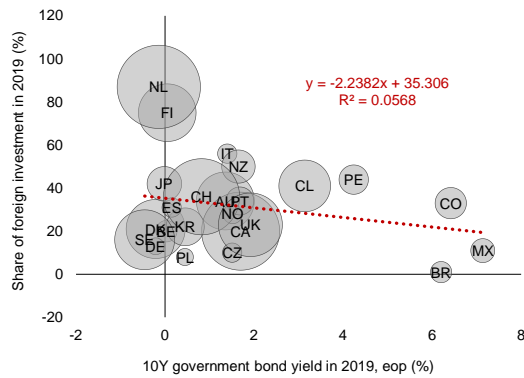
Figure A4.6. Asset Allocation of Pension Funds in 2021



Source: OECD (2023)

9. In addition to diversifying across asset classes, many public pension funds in both advanced and emerging economies also diversify their investments overseas. Given the prevalent low-interest-rate environment in many countries, many pension funds are venturing into foreign markets to seek higher returns and mitigate the idiosyncratic risks associated with their home countries. Among OECD members, countries with low government bond yields and larger pension fund sizes tend to allocate a higher portion of their investments globally (A4.7). In the ASEAN+3 region, several countries have relaxed restrictions or raised targets on foreign investment for pension funds since the Global Financial Crisis in 2008. For instance, Korea’s National Pension Service has gradually increased its medium-term target for investments abroad, Malaysia’s Employee Provident Fund removed the 30-percent cap on foreign investment in 2016, and Thailand’s Government Pension Fund raised the foreign investment limit to 60 percent of total assets under management from 40 percent in 2022 (Table A4.2).

Figure A4.7. Government Bond Yield and Pension Funds' Share of Overseas Investment



Source: PwC; Central Banks; CEIC
Note: The size of bubbles represents the size of the pension fund as a percentage of GDP.

Table A4.2. Global Investment Limit of Public Pension Funds in Select ASEAN+3 Economies

Fund ¹	Regulatory limit on Overseas investments	Actual overseas investment in 2022
JPIF	No limit	50%
HKMPF	30% in HKD assets	40% ²
KNPS ³	10% for equity and 35% for fixed income	34%
MEPF	No limit	35.8%
TGPF	60%	25.4%

Source: PwC; national pension fund management institutions; AMRO staff compilation
Note: 1/ JPIF = Japan's Government Pension Investment Fund, HKMPF = Hong Kong's Mandatory Pension Fund, KNPS = Korea's National Pension Service, MEPF = Malaysia's Employees Provident Fund, TGPF = Thailand's Government Pension Fund; 2/ as of 2018; 3/ The numbers do not include foreign alternative investments.

Institutional Arrangement and Policy Considerations

10. It is worth exploring alternative investment instruments to pursue higher yields and mitigate risks through diversification. The VSS's current asset allocation¹¹⁰ is heavily concentrated in domestic public agencies, exposing it to the country's idiosyncratic risks. New authorized investments, permitted by the Law on Social Insurance 2024, still limit investment options to foreign government bonds, which may not significantly increase the VSS's investment return. Diversifying assets into different types of investments and across various countries can help raise the VSS's investment returns over the long term.

11. It is worth considering incorporating the OECD Core Principles of Private Pension Regulation (OECD core principles) into the subordinate regulations governing the SIF's investment policy. The OECD core principles offer governments, financial regulators, and supervisors the high-level guidance on the regulatory framework, design, and operation of private pensions (OECD, 2016). These core principles are also applicable to public pension funds and pension entities (OECD, 2022). One of the OECD core principles emphasizes the investment of pension fund assets, risk management, prudential standards, and the evaluation of fund performance (Table A4.3).

Table A4.3. A Key Elements of Core Principle 4. Investment and Risk Management

Operating Activity	Implementing Guidelines
Retirement income objective and prudential principles	<ul style="list-style-type: none"> Aligned with the goal of retirement income, investment management and regulations should be in accordance with the prudential principles of <i>security, profitability, and liquidity</i>. Risk management should take into account <i>diversification</i> and <i>asset-liability matching</i>.
Prudent person standard	<ul style="list-style-type: none"> The governing body of pension funds should be subject to a '<i>prudent person standard</i>' and a fiduciary duty towards pension plan members and beneficiaries. The governing body should establish a <i>rigorous investment process</i> including internal control.
Investment policy	<ul style="list-style-type: none"> Overall investment policy should be set forth in a <i>written form</i>. The investment policy should be <i>consistent with retirement income objectives and the characteristics of the liabilities of the pension fund</i>.

¹¹⁰ Law on Social Insurance dated November 20, 2014 and Decree No. 30/2016/ND-CP on detailed regulations on investment activities from social insurance, health insurance, unemployment insurance funds.

	<ul style="list-style-type: none"> The investment policy and strategy need proper diversification and sound risk management, the maturity of the obligations, the liquidity needs, balancing long-term risks and returns, as well as legal limitations on portfolio allocation. The governing body should put in place periodic review on the effectiveness of the investment policy.
Portfolio limits and other quantitative requirements	<ul style="list-style-type: none"> The ceiling of each investment category should promote and balance the prudential principles of security, profitability, and liquidity. Portfolio allocation should be provided with a certain degree of flexibility, taking into consideration of risk diversification and asset-liability matching. Legal provisions should address the use of more complex and less transparent asset classes.
Asset Valuation	<ul style="list-style-type: none"> The valuation of pension assets should be done in a proper, transparent, and disclosed basis.
Performance assessment	<ul style="list-style-type: none"> The performance of both external and internal fund managers should be monitored regularly. The performance assessment should be evaluated over a period of years, taking into account the long-term investment horizon, asset-liability management, and risks.

Source: OECD (2016)

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Address: 10 Shenton Way, #15-08
MAS Building, Singapore 079117
Website: www.amro-asia.org
Tel: +65 6323 9844
Email: enquiry@amro-asia.org

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