INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/235

VIETNAM

July 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR VIETNAM

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Vietnam, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 19, 2019, consideration of the staff report that concluded the Article IV consultation with Vietnam.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 19, 2019, following discussions that ended on April 19, 2019, with the officials of Vietnam on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 4, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Vietnam.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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FOR IMMEDIATE RELEASE
July 16, 2019

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Completes the 2019 Article IV Consultation with Vietnam

On June 19, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation with Vietnam.[1]

Trade tensions and financial volatility affecting emerging economies in 2018 were also felt in Vietnam, including through a stock market correction. Nevertheless, the economy has remained resilient to date and growth reached a 10-year high of 7.1 percent in 2018. The expansion is broad-based, fueled by healthy growth in incomes and consumption of the growing and urbanizing middle class, a strong harvest and surging manufacturing sector. Inflation averaged 3.5 percent in 2018. The strong economic momentum is expected to continue in 2019, aided by competitive labor costs and other strong fundamentals, including a diversified trade structure, and recently signed free trade agreements which are spurring reforms. However, a soft landing of growth is expected, to 6.5 percent in 2019 and over the medium term, reflecting weak external conditions. Inflation is expected to pick up slightly in 2019 on the back of administered price increases but should remain below the authorities' four percent target.

Macroeconomic policies have been tightened in recent years: A reduction in the budget deficit and strict limits on new government guarantees and robust growth during 2016-18 have contributed to reducing public debt to 55.5 percent of GDP at end-2018, from 60 percent at end-2016. The State Bank of Vietnam has continued to reduce credit growth, but liquidity continued to be ample in 2018, aided by external inflows and the growing capital market. The SBV is guiding banks to adopt Basel II standards in 2020 and developing plans to recapitalize systemic state-owned commercial banks. The external position in 2018 was substantially stronger than warranted by fundamentals. The authorities intervened in both directions to keep the Dong within a narrow band and reserve accumulation continued.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Reforms continue along a wide front: the monetary and fiscal systems are being gradually modernized, and blocks of shares in large state enterprises continue to be offered for sale. The fight against grand corruption since 2016 has resulted in significant sentences, a new anti-corruption law has been approved, a PIMA has been completed and the AML/CFT system is about to be reviewed. But the list of reforms is even longer and the strong economy provides an opportunity for more ambitious reforms to level the playing field for the domestic private sector and increase investment by reducing administrative and licensing procedures and trade barriers. IMF staff remains engaged in a wide-ranging capacity development program with Vietnam.

Executive Board Assessment[2]

Executive Directors commended the Vietnamese authorities for their prudent policies which have contributed to economic resilience and impressive growth amidst rising trade tensions and external uncertainties. Directors welcomed the authorities' continued commitment to macroeconomic stability and wide-ranging reforms and agreed that policy priorities should continue to focus on building buffers, strengthening governance, and boosting productivity and private sector-led growth.

Directors welcomed the authorities' fiscal consolidation efforts, especially improvements in tax policy and administration, including higher environmental taxes, the tightening of government guarantees and lower current spending, which helped reduce public and publicly guaranteed debt. They noted that further consolidation should focus on the quality of adjustment so as to keep the public debt on a declining path and create room for priority infrastructure and social spending, prepare for rapid prospective population aging, and deal with the effects of climate change and digitalization. Revenue-enhancing measures should focus on broadening bases, including unifying VAT rates, a property tax, and reducing exemptions and improving tax administration. Directors noted the ongoing efforts to rationalize the public sector wage bill and underscored the need to improve public financial and investment management.

Directors welcomed the current monetary and credit policies stance, especially declining credit growth which is helping Vietnam cement macroeconomic stability. They encouraged the authorities to continue to limit interventions to maintaining orderly market conditions and maintain efforts towards greater exchange rate flexibility while gradually building reserves. Directors called for reforms to reduce remaining barriers to investment, including improving access to land and credit, that would boost private investment and raise worker productivity

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

and growth. They looked forward to a well-sequenced modernization of the monetary framework with technical assistance from the Fund.

Directors noted ongoing reforms in the financial sector, including the shift of bank business models to lending to households and private firms, accompanied by more prudent aggregate credit growth limits and the deepening of bond and equity markets, which has reduced financial stability risks, improved the quality of financial intermediation and boosted economic growth. Directors welcomed the adoption of Basel II standards and encouraged swift recapitalization of the systemic state-owned banks and the construction of a modern macroprudential framework to replace quantitative credit limits and deal with potential financial stability risks.

Directors welcomed the reforms to modernize economic institutions and improve governance. They highlighted that priority needs to be given to strengthening anti-corruption legislation further, reforming and improving oversight of state-owned enterprises, implementing Public Investment Management Assessment recommendations, and improving statistical systems and data provision and transparency. Directors welcomed the authorities' plan to strengthen the AML/CFT regime and address any related issues to be identified by the forthcoming peer review by the Financial Action Task Force's Asia Pacific Group.

Vietnam: Selected Economic and Financial Indicators, 2014–2020

				Est.	Projections		
	2014	2015	2016	2017	2018	2019	2020
Output							
Real GDP (percent change)	6.0	6.7	6.2	6.8	7.1	6.5	6.5
Prices (percent change)							
CPI (period average)	4.1	0.6	2.7	3.5	3.5	3.6	3.8
CPI (end of period)	1.8	0.6	4.7	2.6	3.0	3.7	3.8
Core inflation (end of period)	2.7	1.7	1.9	1.3	1.7	2.1	2.2
Saving and investment (in percent of GDP)							
Gross national saving	35.9	32.5	36.0	35.5	36.0	35.6	35.3
Gross investment	31.0	32.6	33.0	33.4	33.5	33.4	33.4
Private	18.6	20.2	20.7	21.5	22.4	22.6	22.7
Public	12.4	12.4	12.4	11.9	11.2	10.8	10.7
State budget finances (in percent of GDP) 2/							
Revenue and grants	22.2	23.8	24.0	24.5	24.5	23.4	23.3
Of which: Oil revenue	2.5	1.6	0.9	1.0	1.0	0.7	0.6
Expenditure	28.5	30.2	27.8	29.2	28.8	27.8	27.6
Expense	20.4	21.4	20.4	21.3	20.8	20.1	20.0
Net acquisition of nonfinancial assets	8.1	8.8	7.4	8.0	8.0	7.6	7.6
Net lending (+)/borrowing(-) 3/	-6.3	-6.4	-3.9	-4.7	-4.4	-4.4	-4.2
Net lending /borrowing including EBFs	...	...	...	-2.9	-2.6	-2.6	-2.6
Public and publicly guaranteed debt (end of period)	54.7	57.1	59.7	58.2	55.6	54.4	53.3
Money and credit (percent change, end of period)							
Broad money (M2)	17.7	16.2	18.4	15.0	12.4	15.5	14.9
Credit to the economy	13.8	18.8	18.8	17.4	12.7	13.7	13.1
Interest rates (in percent, end of period)							
Nominal three-month deposit rate (households) 4/	5.0	4.8	4.9	5.9	5.9	...	...
Nominal short-term lending rate (less than one year) 4/	8.5	7.2	7.2	8.7	8.7	...	...
Balance of payments (in percent of GDP, unless otherwise indicated)							
Current account balance (including official transfers)	4.9	-0.1	2.9	2.1	2.4	2.2	1.9
Exports f.o.b.	80.9	84.7	87.7	97.6	101.2	104.8	108.8
Imports f.o.b.	74.3	80.8	82.2	92.7	94.6	98.7	103.0
Capital and financial account 5/	3.0	0.5	4.6	9.0	0.0	2.0	2.2
Gross international reserves (in billions of U.S. dollars) 6/	34.3	28.3	36.7	49.2	55.3	66.2	77.7
In months of prospective GNFS imports	2.4	1.9	2.0	2.4	2.4	2.5	2.6
Total external debt (end of period)	38.3	42.0	44.8	49.0	46.0	47.2	47.5
Nominal exchange rate (dong/U.S. dollar, end of period)	21199.6	21951.3	22371.8	22709.0	23175.0	...	...
Nominal effective exchange rate (end of period)	93.9	97.6	97.7	91.2	93.1	...	...
Real effective exchange rate (end of period)	124.7	129.8	134.0	126.2	131.0	...	...
Memorandum items:							
GDP (in trillions of dong at current market prices)	3937.9	4192.9	4502.7	5006.0	5535.3	6084.0	6695.0
GDP (in billions of U.S. dollars)	185.8	191.3	201.3	220.4	241.3	260.5	282.4
Per capita GDP (in U.S. dollars)	2047.4	2085.7	2172.0	2353.4	2551.1	2728.4	2929.2

Sources: Vietnamese authorities; and IMF staff estimates and projections.
1/ The national accounts has been re-based to 2010 from 1994 by the authorities.
2/ Follows the format of the Government Finance Statistics Manual 2001. Large EBFs are outside the state budget but inside the general government (revenue amounting to 6-7 percent of GDP).
3/ Excludes net lending of Vietnam Development Bank and revenue and expenditure of Vietnam Social Security.
4/ Latest available for 2018.
5/ Incorporates a projection for negative errors and omissions going forward (i.e. unrecorded imports and short-term capital outflows).
6/ Excludes government deposits.

INTERNATIONAL MONETARY FUND

VIETNAM

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

June 4, 2019

KEY ISSUES

Outlook and risks. Rising trade tensions and volatility in emerging economies were felt in Vietnam in 2018. Nevertheless, the real economy remains resilient, the private sector-led expansion is broad-based, and inflation remains muted. The public finances are being consolidated, bank capital rules strengthened, and capital markets are deepening. Risks are related to geopolitics, trade policy uncertainty and domestic reform implementation. Longer term risks relate to aging, climate change and digitalization.

Fiscal policy. Gradual fiscal consolidation, strict limits on government guarantees and robust growth in recent years have led to declining government debt, expected to continue under current policies. But while there is some fiscal space, fiscal needs are large, for infrastructure, social spending and to deal with population aging and climate. IMF technical assistance is assisting fiscal reforms, including in public financial management and revenue administration.

Money, credit and banking. The tightening of credit growth continued in 2018 but liquidity remained ample, aided by the strong balance of payments and tight fiscal policies. The State Bank of Vietnam has initiated plans to modernize its monetary framework with IMF technical support. It is guiding banks to adopt Basel II standards in 2020, which is unlocking reforms and recapitalization of state-owned banks.

External assessment. The external position in 2018 was substantially stronger than warranted by fundamentals, reflecting distortions that inhibit private domestic investment. The authorities intervened in both directions to keep the Dong within a narrow band. Reserve accumulation continued but reserves are still less than needed in the context of the managed exchange rate regime.

Governance and corruption. The authorities' efforts to improve economic institutions and governance continue and the fight against grand corruption has resulted in significant sentences in recent high-profile cases. Improvements in transparency and statistical systems are underway, with support from the IMF and the Financial Action Task Force's (FATF) Asia Pacific Group. New anti-corruption legislation has been adopted, Public Investment Management Assessment (PIMA) recommendations drawn, and strengthening of AML/CFT efforts envisaged following the FATF review.

Approved By
Anne-Marie Gulde-Wolf and Rupa Duttagupta

Discussions took place during April 3–19, 2019. The IMF team comprised Alexandros Mourmouras (Head), Angana Banerji, David Corvino (all APD), Anja Baum (FAD), Mitsuru Katagiri (MCM), and Naoko Miake (OAP). Nga Ha and Van Anh Nguyen (from the IMF Office in Hanoi) supported the team's discussions and policy work excellently. Albe Gjonbalaj and Ross Rattanasena (both APD) and Hai Hoang (IMF Office in Hanoi) provided superb research, editorial, and logistical assistance respectively for the discussions and the preparation of this report

CONTENTS

Glossary

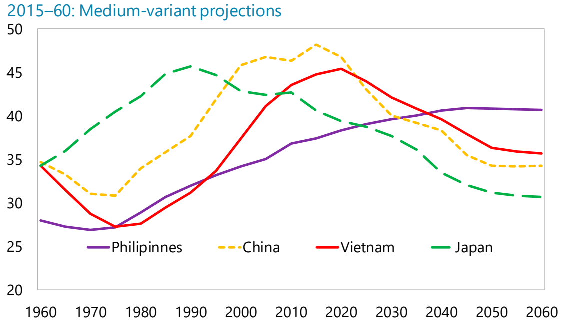
AML	Anti-money laundering
APG	Asia Pacific Group
CA	Current account
CARs	Capital adequacy ratios
CFM	Capital flow management measures
CFT	Combatting the financing of terrorism
CIT	Corporate income tax
CPI	Consumer Price Index
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
DSA	Debt Sustainability Analysis
EBA	External Balance Assessment
EBFs	Extrabudgetary funds
eGDDS	General Data Dissemination System
FATF	Financial Action Task Force
FDI	Foreign direct investment
FTA	Free trade agreement
FX	Foreign exchange
GDP	Gross domestic product
GFSM	Government Finance Statistics Manual
GG	General Government
GSO	General Statistics Office of Vietnam
IT	Inflation Targeting
LTV	Loan-to-value ratio
MOF	Ministry of Finance, Vietnam
NA	National Assembly, Vietnam
NPL	Non-performing loans
ODA	Official development assistance
PIMA	Public Investment Management Assessment
PPG	Public and Publicly Guaranteed
SBV	State Bank of Vietnam
SCMC	State Capital Management Committee
SDDS	Special Data Dissemination Standard
SOCB	State-owned Commercial Banks
SOE	State-owned enterprise
TA	Technical assistance
US	United States, the
VAMC	Vietnam Asset Management Corporation
VAT	Value-added tax
VSS	Vietnam Social Security

CONTEXT

1. **Background.** Extensive market reforms since the dawn of the *doi moi* era in 1986, and strict commitment to macroeconomic stability more recently, have laid the ground work for rapid, inclusive growth that averaged 6.6 percent per annum during 2014–18 and reached a 10-year high of 7.1 percent in 2018. Reforms in recent years include fiscal consolidation, strengthening of financial buffers and the banking sector and privatization of state-owned enterprises (SOEs). Vietnam signed trade agreements, improved governance and made impressive progress in internet penetration and digitalization. Its achievements notwithstanding, however, Vietnam faces important challenges, including tackling residual aspects of dualism in its twin transition from plan to market and from farms to factories and services. Vietnam must upgrade its growth model to exploit rapid digital innovation that is reshaping supply chains (Regional Economic Outlook, 2018; Box 1). Vietnam also has a narrow 20-year window before rapid aging sets. The strong economy provides an opportunity for more ambitious reforms to modernize its economy and enhance its flexibility and resilience to shocks.

Vietnam: Selected Countries: Prime Working Age Population, 1960–2060

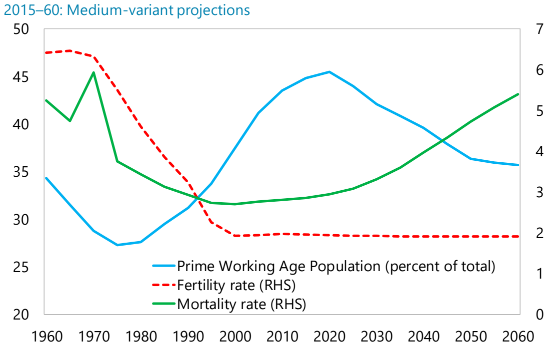
2015–60: Medium-variant projections



Source: United Nations World Population Prospects 2017.

Vietnam: Prime Working Age Population, 1960–2060

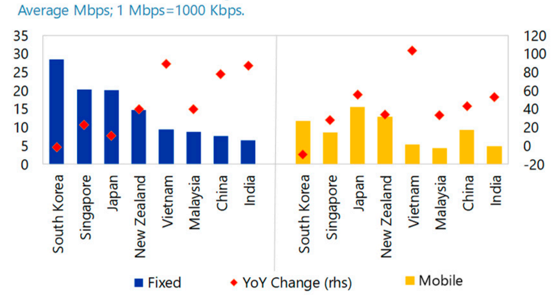
2015–60: Medium-variant projections



Source: United Nations World Population Prospects 2017.

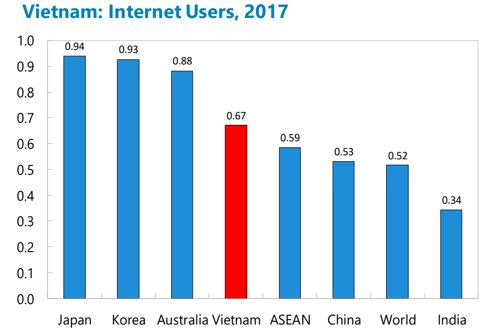
Vietnam: Connection Speed, 2017

Average Mbps; 1 Mbps=1000 Kbps.



Source: Akamai's State of the Internet Report, 2017 Q1 and 2016 Q1.
Note: Red dots in the right hand side indicate the change in connection speed between 2016 and 2017.

Vietnam: Internet Users, 2017



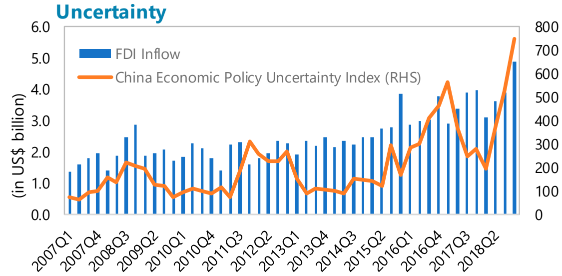
Note: Internet Users per Capita; Growth since 2014.
Sources: Internet Live Stats; and IMF staff calculations.

RECENT DEVELOPMENTS

2. Resilient Growth. Rising trade tensions and volatility in emerging economies in 2018 were felt in Vietnam, including through a stock market correction. Nevertheless, the economy remained resilient with growth of about 7 percent continuing into 2019 Q1 (6.8 percent relative to 2018 Q1). The broad-based expansion was fueled by growth in incomes and consumption and by strong trade, tourism and remittances. Manufacturing surged and direct investment inflows remained strong. The trade surplus widened in 2018 but export growth slowed down in 2019 Q1 reflecting slower smartphone exports. Headline inflation averaged 3.5 percent and core inflation 1.5 percent in 2018. Inflation remained contained: it reached 2.9 percent in April relative to a year ago, below the 4 percent target. Core inflation remained steady at 1.9 percent.

3. Trade tensions. The United States and China are important trade and investment partners. Quantitative models suggest a small positive overall impact on Vietnam from trade tensions (- 0.3– 0.8 percent change in exports) because gains in US market share from trade diversion, given that Vietnam's exports to the U.S. are similar to China's, are largely offset by lower exports to China of intermediate and capital goods through the regional manufacturing supply chain. A potentially larger and more durable impact could come from shifts in investment. In recent years, international firms have been moving facilities to Vietnam in response to rising costs in China and the desire to diversify production locations (chart). Trade policy uncertainty may remain elevated even if negotiations lead to a trade truce. Vietnam's demonstrated ability to move up the manufacturing value chain makes it well placed to benefit from investment redirection.

Vietnam: FDI inflows and China Policy Uncertainty



Sources: Vietnamese authorities; 'Measuring Economic Policy Uncertainty' by Baker, Bloom and Davis; and IMF staff caclulations

4. Outlook. A soft landing of growth is expected in 2019 to 6.5 percent, the economy's potential, as credit growth tightens and major trading partner growth decelerates. Headline inflation is projected at 3.6 percent, and core inflation at 2.1 percent. Over the medium term, growth is expected to slow down to a more sustainable pace of growth of 6.5 percent, the economy's potential growth rate, consistent with the implementation of ongoing reforms, including privatization and reducing the economic role of the state, and constraints from infrastructure and other structural gaps and fiscal consolidation. Inflation is likely to remain close to target, four percent per annum.

5. Risks. Downside risks have risen (Appendix I). External risks from slower partner country growth and trade policy uncertainty remain elevated; they dominate the balance of risks. Banking sector fragilities continue to pose risks, although the bank recapitalization under way is a mitigating factor. Bottlenecks related to the anti-corruption campaign could delay investment. On the upside, Vietnam's numerous free trade agreements (FTAs) could usher in productivity gains. Growth could also surprise on the upside if trade diversion and investment relocation effects continue.

6. External Assessment. Vietnam's external position in 2018 was substantially stronger than warranted by fundamentals. The Current Account (CA) gap reached 6.4 percent of GDP and exchange rate undervaluation 8.4 percent (Appendix II). International reserves rose to U.S.$ 65 billion, 24 percent of GDP and 76 percent of the ARA metric at end-April 2019. The gap reflects domestic distortions and residual dualism in Vietnam's economy—especially barriers to accessing land, credit and an uneven playing field for domestic private firms—that discourage private domestic investment. More ambitious structural reforms are needed to: strengthen private investment; improve the efficiency of public investment; greater two-way exchange rate flexibility. And while Vietnam's commitment to diversify trade is strong—they have signed numerous FTAs—there is more room to tackle domestic trade barriers, especially non-tariff ones.

Authorities' Views

7. The authorities broadly shared staff's assessment. They reaffirmed their commitment to macrofinancial stability and view their 2019 growth target (6.6–6.8 percent) is achievable. Inflation could increase due to higher food and administered prices but should remain below target. They took note of the external assessment but stressed that different approaches yield different results. They emphasized that the State Bank of Vietnam (SBV) intervention is bidirectional and 2018 Dong depreciation was less than other countries. They agreed with the need to further strengthen investment through structural reforms. They are revising their foreign direct investment (FDI) strategy to ensure greater linkages with domestic industry.

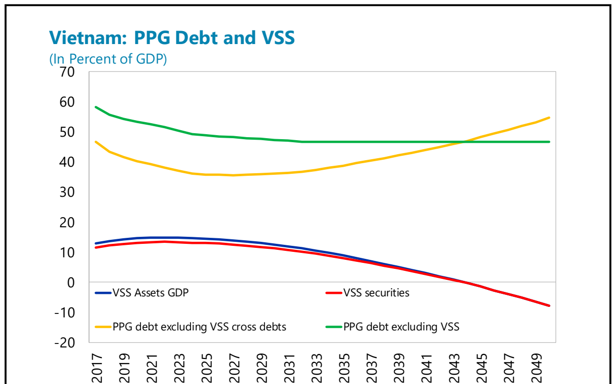
POLICY ISSUES

The government's commitment to fiscal adjustment is welcome but its quality should improve, and specific measures enacted to ensure timely implementation. The tightening of credit policies and development of capital markets are also welcome, and the authorities should work on building a modern market infrastructure and macroprudential tools. The authorities should use the fiscal space in the event downside risks materialize. Conversely, if growth surprises on the upside, a faster pace of fiscal consolidation would be warranted, and other policy levers may need to be recalibrated based on the implications for the broader macro-financial outlook. The move to Basel II and recapitalization of state-owned commercial banks (SOCBs) should not be delayed. Efforts to address governance and corruption provide an opportunity to strengthen the rule of law.

Fiscal Policy

8. Background. In recent years, Vietnam has reversed the rapid rise in public and publicly guaranteed (PPG) debt seen in the years up to the 12th Party Congress of January 2016. It has implemented significant fiscal consolidation, strictly limiting the issuance of government guarantees and stabilizing the state budget deficit to about 4.6 percent of GDP in 2017–18 (GFS measure), down from 5.5 percent in 2014–2016. When the surplus of Vietnam Social Security (VSS), the pay-go pension system, and other extrabudgetary funds (EBFs) is included, the general government (GG) deficit averages 2.7 percent of GDP in 2017– 18.

9. Recent developments. A strong economy and better revenue administration helped buoy 2018 revenues, while slower public investment helped contain spending. PPG debt declined to 55.6 percent of GDP at end-2018, down 4 points of GDP from its 2016 peak (Table 4b and Appendix III, DSA). The authorities plan to continue their gradual fiscal consolidation, with measures to strengthen tax policy and administration and contain current spending. The state budget deficit projected to decline to 4.2 percent in 2020 (2.6 percent with EBFs). Under staff's baseline, PPG debt is on a decidedly downward trend, to 53.2 percent of GDP by 2020 and 49.3 percent in 2024 (Appendix III), in line with past IMF recommendations. Growing reliance on non-debt creating deficit financing, lengthening of debt maturities, and low interest rates should all help contain debt service costs.



Source: IMF Staff estimates.

Staff Position

10. Continue tackling PPG debt, improve the quality of fiscal adjustment. Staff commends the authorities for lowering Vietnam's PPG debt in recent years, which has resulted in Vietnam currently having some fiscal space. Staff supports the authorities' plans to continue fiscal consolidation, which is sending a strong signal of their continued commitment to fiscal sustainability. They should enact specific fiscal measures to ensure timely implementation of their deficit targets while raising the quality of fiscal consolidation. They should strive to preserver the strong revenue mobilization (24 percent of GDP at the state budget level, 31 percent with EBFs) considering declining official development assistance (ODA), oil and trade revenues. It would be helpful to lower the statutory PPG debt ceiling—Vietnam's fiscal anchor—from 65 to 50 percent of GDP in 2024—to create more fiscal space to boost public investment and deal with fiscal risks associated with SOEs and banking sector contingent liabilities, aging and climate change.

11. On the revenue side, recent increases in environmental and excises are welcome. Nevertheless, more fundamental tax reform is needed to broaden tax bases, reduce informality incentives and mitigate the decline in ODA, oil and trade revenues. Staff encourages a broad tax policy review, including VAT (domestic VAT collections have weakened); excises; CIT; tax incentives and transfer pricing; property tax and current transaction and stamp duties, (very low). The establishment of property and land registries should be sped up.

12. On the expenditure side, the gradual, ongoing reduction in public employee numbers and increase of base salaries are welcome. But there is more room to rationalize the public sector wage bill. They should consider an in-depth analysis of staffing needs for the next 5-year plan. Social and infrastructure spending needs are large, including for health, pensions and public investment. As suggested by the Public Investment Management Assessment (PIMA), the level and efficiency of infrastructure investment should be raised and private funding via public private partnership (PPP) agreements should be considered.

13. Economic and social inclusion. Vietnam's growth has been inclusive to date and poverty fell from over 60 percent to below 5 percent in the last 30 years. Social spending, on health and education, has been critical in achieving inclusive growth. But it has declined slightly in recent years and the SDG costing exercise points to large gaps in health and infrastructure spending: 7 percent of GDP annually in public and private spending, of which 1 percent in health and the rest in roads, water and electricity. The private sector is expected to play a large role in financing of the SDGs, and improved investment efficiency with reduced current spending will free fiscal space. While there is no funding gap in education, the focus on primary and secondary education, where PISA scores point to high attainment, is appropriate. Access to tertiary education should be maintained; universities and vocational institutions should work with government and industry to reduce skills mismatches.

14. Preparing for population aging. Demographics have been favorable to date, but pension reforms are needed to address unfunded pension liabilities and improve the coverage, adequacy, sustainability and intra- and inter-generational fairness of pensions. Under current policies VSS outlays will overtake revenues in the 2030s. Policy changes to the Pension Fund are about to be discussed in the National Assembly (NA) (draft Labor Code), including the increase in retirement ages from 60 to 62 for men, and 55 to 60 for women, and more stringent eligibility and base calculation criteria. Swift implementation of these reforms and continued monitoring and adjustments to address unfunded pension liabilities would be desirable. The reforms should also ensure that vulnerable groups are adequately protected in old age and that poverty in old age does not rise. VSS and other EBFs should be integrated in the macro-fiscal framework.

15. Health Insurance Fund. The recent expansion in public health care coverage (88.5 percent in 2018) and growing per capita health care spending are driving health care spending higher (from 7.9 percent of the budget in 1995 to 14.2 percent in 2014) and the Health Insurance Fund has swung into deficit. VSS plans to strengthen cost controls, consolidate collections of tax and social security premiums and raise co-payments are welcome. The authorities should also enhance the referral system; increase competition in pharmaceuticals; create an electronic patient records system; and address high out-of-pocket spending. More pre-funding of health care costs and improvement in collections and reducing informality should be examined.

Fiscal Systems

16. Fiscal accounting and reporting. Partial coverage and long reporting lags lead to unreliable estimates of the GG fiscal position. GFSM representations of the entire general government should be introduced and become the standard presentation in 2021–30. The spending carry-forward should be further limited, and the practice of revenue carry forward eliminated. The financing sources of the general government should be elaborated and lags in reporting sub-national budget outcomes should be shortened. Vietnam's Ministry of Finance (MOF) should require EBFs to provide detailed quarterly reports. Budget documents should include medium-term debt sustainability analyses and fiscal risk statements. TA in fiscal reporting is a priority.

17. Public debt management has improved noticeably but more flexibility is needed. Treasury bonds are issued at a minimum of 5-year maturity. While this has eased planning and lowered rollover risks of public debt, it prevents more active cash management and slowing money market development. The issuance of T-bills would provide a risk-free security that would help to complete the short end of the yield curve. More active cash management would also minimize net borrowing costs. To reduce high levels of government cash balances, cash held at the commercial banks should be swept into the SBV daily, as per IMF TA advice.

Authorities' Views

18. Staying the fiscal course. The authorities broadly agreed with staff's views. They are committed to continued fiscal consolidation and are enforcing the statutory debt limit and the cap in the state budget deficit. Public debt and guarantees and public sector headcount are being reduced further and public investment remains shielded from cuts. PIMA recommendations are reflected in the new Public Investment Law. They are drafting a law on PPPs which will help limit risks related to PPP procurement and management.

19. Tax policy and administration. The authorities are confident that they will be able to increase revenue further, based on administrative reforms, including the use of IT and digitalization, to broaden revenue bases. They are studying options for property taxation and registries. The authorities continue to review the different tax policy laws, which will take more time than expected given ongoing strong opposition. The MOF is considering adopting policies through the draft Tax Administration Law which will be read by the NA in its May-June session. [1]

20. Social security. The authorities agreed that the coverage of public pensions is narrow but argued that high informality makes further expansion challenging. They are reviewing the calculation used to determine pensions (lifetime wages) and will replace it with wages during the five years before retirement. On health, they agreed that expansion in coverage combined with limited expenditure control resulted in cost escalation.

21. Public debt management. The authorities continue to be focused on improving debt management: public guarantees are granted only sparsely, external debt is being further reduced, and bond maturities lengthened. The benefits of issuing short term bills to assist financial market development and monetary policy will be implemented.

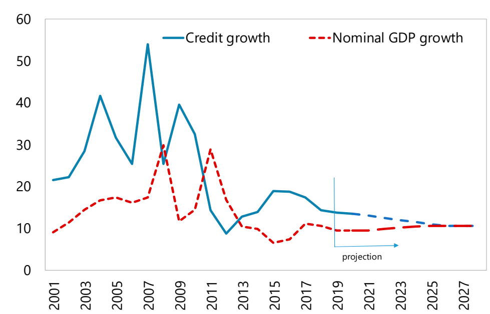
22. Fiscal accounting. The authorities are addressing fiscal accounting issues and the new PIL will limit investment carry-over. However, revenue carry-forward is likely to remain. They are planning to present GFSM-conforming fiscal accounts to the NA in 2020 but deemed the integration of social security into fiscal accounting unlikely in the short-term.

[1] Planned administrative measures to increase revenue include: (i) Strengthening cooperation among the General Department of Taxation, Customs Office, SBV, Ministry of Security and other institutions to enhance coordination, strengthen supervision and reduce tax arrears; (ii) Adopting electronic tax transactions; (iii) Adopting risk management in tax administration; (iv) Requiring enterprises to use electronic invoices in transaction of goods sales and service provision; (v) Strengthening measures to combat tax base erosion, tax evasion and profit shifting.

Credit, the Exchange Rate and Monetary Policy

23. Credit growth. Aggregate and bank-by-bank limits on credit growth are a key plank of SBV's monetary framework. Excessive credit growth and low loan quality before 2011– 12, including lending to SOEs and a property boom fed by credit, have left Vietnam with twin legacies of high bank credit-to-GDP and elevated non-performing loans (NPLs). In recent years, the authorities have gradually brought credit growth down, to 17.4 percent in 2017 and less than 13 percent in 2018, and resolved large quantities of NPLs. They are seeking to constrain real estate lending by imposing higher risk weights and limiting short-term funding for long-term projects. The SBV also sought to limit consumer lending by introducing a cap on the share of cash loans and prohibiting lending to borrowers with weak credit. Tighter bank credit is helping to accelerate the development of capital markets: large credit worthy companies are now able to access markets on favorable terms. Plans to create a credit rating agency are at an advanced stage. The SBV plans to lower credit growth further, to close to nominal GDP growth. Vietnam is also moving to adopt Basel II standards by January 2020 and banks that meet the standards will be granted higher credit ceilings. Over the medium term, the SBV intends to replace administrative allocation of credit with market-based mechanisms.

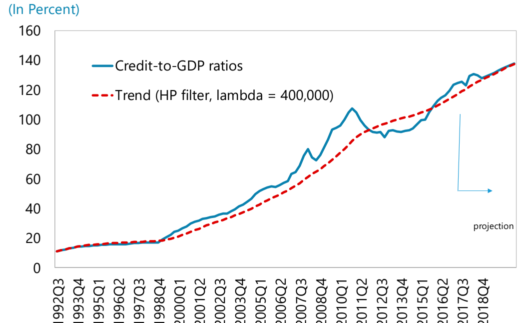
Vietnam: Credit growth and Nominal GDP growth



Sources: National authorities' data and IMF staff calculations.

Vietnam: Credit-to-GDP

(In Percent)

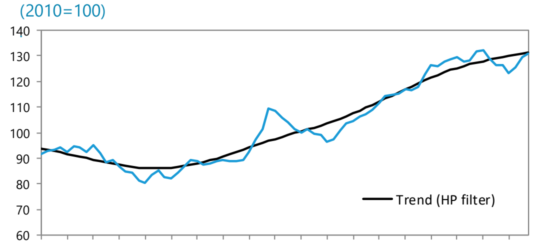


Sources: National authorities' data and IMF staff calculations.

24. Exchange Rate Developments. The exchange rate is SBV's principal nominal anchor—it manages the Dong within a three percent band. It bought reserves in the first half of 2018, continuing the real appreciation trend of 2016–17 (Appendix V). When the currency came under moderate pressure in July 2018, the SBV intervened in the opposite direction to limit the depreciation of the Dong vis-à-vis the U.S. dollar while short term interest rates rose close to the repo rate. As risk-on conditions returned in late 2018, the SBV resumed reserve purchases in early 2019. In all,

Vietnam: Real Effective Exchange Rate, 2000Q1—2018Q4

(2010=100)



Source: IMF staff estimates.

the Dong depreciated by a modest 2.1 percent vis-à-vis the U.S. dollar in 2018, although it appreciated by 3.8 percent in REER terms, reflecting depreciation of the RMB. In the face of strong inflows, the SBV kept the Dong broadly stable vis-à-vis the U.S. dollar in 2019 Q1.

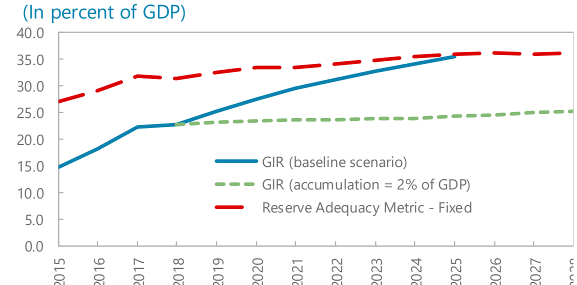
Staff Position

25. Credit growth. Staff welcomes the moderate tightening of monetary and credit policies (lower credit growth, higher interbank interest rates) as well as the planned prudential measures to contain real estate and consumer lending, although there is scope to do more to contain prices in segments of the property market. Credit growth should gradually come down to close to the rate of growth of nominal GDP and interest rates kept constant given stable growth and inflation approaching target. The SBV should focus real estate lending measures more narrowly on property developers where risks are larger. Higher credit ceilings for banks that meet Basel II capital requirements are also welcome. Market-based credit allocation would help boost productivity by improving the efficiency of credit allocation across banks and borrowers. This transition should be carefully executed to minimize potential monetary and financial stability risks. It must be accompanied by a stronger banking sector and intensified efforts to address data gaps. More information is needed on high corporate debt (140 percent of GDP), and private external debt (25 percent of GDP).

26. Monetary modernization. The authorities maintain a cautious, gradual approach to modernizing their monetary framework, and the modernization of monetary policy will take between six and eight years. Capacity development provided by the Fund is expected to play a key role: a multi-year project to help build the SBV undertake forecasting and policy analysis is being drawn up, part of the blueprint drawn with the help of IMF TA in 2017.

27. The exchange rate and reserves. In response to the heightened volatility of mid-2018, SBV intervention (including the use of forwards) sought to maintain orderly market conditions while limiting the depreciation of the Dong vis-à-vis the U.S. dollar. In the near term—taking the exchange rate regime as given—the SBV could allow greater exchange rate flexibility within the three percent band. It could consider modest nominal appreciation vis-à-vis the U.S. dollar within the band, both to condition market expectations and to help reverse still-substantial cash dollarization (U.S. dollar hoards are U.S. $60 billion or 25 percent of GDP). If faced with persistent large shocks, the SBV should re-center the band. With the switch to IT expected to take several years, gradual reserve accumulation should continue until 100 percent of the ARA metric for a pegged regime is reached. Staff assumes this second-best policy will allow SBV reserves to reach near 100 percent of the ARA metric by 2024. The exchange rate band should be gradually widened in the context of the shift to IT.

Vietnam - Gross International Reserves 2015–28
(In percent of GDP)



Sources: Vietnamese authorities; and IMF staff calculations.

Staff Position

28. Staff welcomes the SBV's commitment to modernize its monetary policy framework. It urges realistic assessments of the constraints imposed by dollarization and its own capacity to use the interest rate as an operational target. Since interbank rates are too volatile to be an operational target of monetary policy, the SBV should, first, stabilize the interbank market rate within a narrow band by paying interest on reserves. Then, it should phase out credit growth targets and start using an interbank rate as a main operational target for monetary policy. A successful transition to a price based monetary policy regime is predicated on a stronger and well capitalized banking system.

29. Future inflation target. Continuing administered price liberalization is expected to add about two percentage points to the CPI. The inflation target for 2021–30 must be considered in the context of establishing a modern IT framework. Experience suggests that it may be premature to lower the target for 2021–30 below 4 percent now. The target should be subject to infrequent reviews and a tolerance range of one percent to deal with volatile CPI components.

Banking Sector

30. Bank earnings have improved in recent years. The shift to retail lending and fee income has contributed to profitability, although growth has slowed down recently. The share of fee incomes related to, for instance, corporate bond issuance, credit card and cash transfer has increased. As large firms issue more corporate bonds, banks have increased credit to SMEs recently. Fintech helps banks to expand their customer base, fostering inclusion.

31. Non-Performing Loans. Banks have stepped up the resolution of legacy loans, aided by the strong economy and rising real estate prices. NPL ratios have been declining, and banks have aggressively bought back NPLs from the Vietnam Asset Management Corporation (VAMC). Resolution 42 of 2017 helped resolve NPLs more efficiently, by providing more legal powers to seize collateral and opportunities to sell NPLs at auction. The implementation of Resolution 42 is facilitated by better coordination among ministries, local governments and the courts.

32. Bank Capital. Strengthening bank capital is in progress, catalyzed by the deadline for implementing Basel II rules (Circular 41). Most large private banks are well capitalized to meet Basel II rules thanks to retained earnings backed by high profitability and equity injections from foreign investors. Systemic SOCBs, on the other hand, face a capital shortfall of two percent of GDP. Foreign ownership limits (FOLs), regulations on new equity issues and rapid growth in credit demand all contributed to lowering CARs. The authorities have formulated a bank-by-bank strategy for recapitalizing large SOCBs, with financing sources under internal discussion.[2] They are urged to raise CARs by issuing equity to private investors, disinvesting from private bank and non-bank entities, and shrinking balance sheets. If these measures do not suffice, they will be permitted to retain

[2] Two systemic SOCBs have issued equity to foreign investors within FOLs and a third would be permitted to retain more earnings. The sale of a state-owned weak bank to a foreign investor is about to close, and discussions with foreign investors on the other two weak banks continue.

earnings. Budget resources are not expected to be used at this point. Raising FOLs for healthy banks is not on the table now, although FOLs for weak banks are (up to 100 percent).

33. **Macrofinancial measures and risk management.** The SBV has stepped up prudential measures, including a cap on the ratio of short-term funding to long-term lending. It has also strengthened its banking sector stress tests and monitoring of early warning indicators. CARs for some SOCBs, where the increase in consumer finance has been significant, have declined. Balance sheet stress tests show that the largest risks for them are related to liquidity and credit. As indicated in paragraph 32, systemic SOCBs are now being recapitalized. A high-level, multi-agency National Financial and Monetary Advisory Council has been created, chaired by the Deputy Prime Minister. It is charged with monitoring system-wide risks and providing advice on policy measures as financial markets deepen, become more interlinked and are liberalized. Greater information sharing and transparency throughout the government should facilitate macrofinancial risk management.

Staff Position

34. **NPL resolution and bank recapitalization.** Staff welcomes the progress in resolving NPLs and recapitalizing banks. The level of NPLs should be carefully monitored. With the recent steps to strengthen the implementation of Resolution 42, it is expected that its policy effects will continue in the future and that NPLs will continue to come down from the still-high current level (6.5 percent) to close to the average for emerging market economies (4-5 percent). Staff urges attention to emerging balance sheet risks arising from the shift of banks to retail lending, including consumer lending used for real estate investment and welcomes the SBV's request for IMF TA on financial stability assessment. Since NPL resolution is partly driven by growing real estate prices, there is a risk that it could be interrupted by a downturn. The recent slowdown in credit growth means that the decline in NPL ratios associated with rapid increases in credit cannot be expected in the future. The SBV should strengthen its macroprudential framework along the lines recommended in SM/18/125 (paragraph 21), including loan-to-value and debt service-to-income requirements to deal with potential risks from the rise in consumer and mortgage loans.

35. **Basel II adoption.** Staff welcomes the adoption of Basel II standards. The authorities should continue to strengthen the banking sector and use the January 1, 2020, Basel II deadline as an opportunity to restructure and consolidate the banking sector as necessary. The bank recap strategy should focus on: equity issues to the private sector including raising FOLs beyond current plans (strong foreign investors may need at least 51 percent holdings to invest); retained dividends, and some injection of state funds. In addition, some bank bond issuance could be allowed to boost Tier 2 capital. To secure enough capital for SOCBs in the long run, it may be useful to set out a clear rule regarding retained earnings for SOCBs, along with raising FOLs and lowering the minimum state share.

36. **Financial liberalization.** Plans to liberalize the financial system should be carefully sequenced. A well-capitalized banking system, a strong modern macroprudential framework and bank supervision, and enhanced capacity for financial stability assessments are preconditions. Despite significant progress on all these fronts, there is need to build additional capacity which

cannot be achieved overnight. It is therefore prudent to maintain credit ceilings for the time being while allowing banks which have achieved Basel II standards more room for lending. Given the substantial progress made by the SBV in its Financial Stability Reports, it could be disseminated more widely.

37. Improved data for risk management. To further enhance risk assessments, early warning systems and macroprudential policies, more and better data is needed in: real estate prices, household and corporate leverage, evergreened loans, and SME balance sheets. Information sharing across agencies must be strengthened. Forthcoming IMF TA with GSO and the MOF will aim at improving real estate statistics; the SBV can play an important role once the bank lending survey comes on stream. Requiring banks to report collateral values would help the SBV better assess credit risks over time.

Authorities' Views

38. Monetary policy. The authorities consider that their monetary policy response to the risk-off episode of 2018 was effective—it persuaded markets of their commitment to maintaining orderly fx market conditions. Going forward, their most important goal continues to be maintaining inflation below target: they will further tighten credit growth.

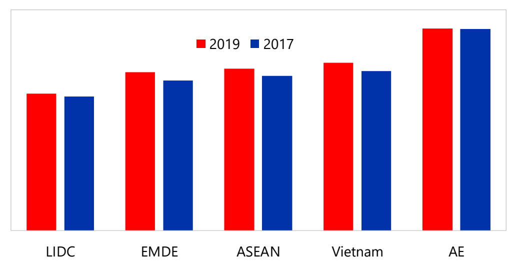
39. Credit growth ceilings. The SBV agreed that bank-by-bank credit caps should be removed but argued that this was not the right time to do so, citing the need to maintain financial stability while a modern macroprudential framework is being developed. They will start liberalization by allocating higher credit caps to banks that satisfy Basel II, followed by a move away from bank-by-bank credit caps in the long run.

40. Banking sector. The authorities concurred that satisfying Basel II capital rules is a milestone and that recapitalizing the systemic SOCBs is an urgent and necessary means of achieving it. Prudential measures, such as the cap on the ratio of short-term funding to long-term lending, will be tightened as necessary. They welcome IMF TA to further develop prudential policy and stress testing.

41. Capital markets. The authorities agreed that growing equity and bond markets are important for Vietnam's future. They expect that ongoing revisions to the Securities Law will enhance market transparency and encourage investment from abroad. They view capital market financing as the main source for medium- to long-term investment funds.

Modernizing Economic Institutions

42. Overview. Vietnam is committed to private sector-led growth and is emphasizing the state's enabling function over public production: regulatory quality and the ease of doing business have improved; and the SOE legal framework was revamped with the creation of an independent State Capital Management Committee (SCMC), which oversees large SOEs and improves accountability and efficiency while leaving management and regulation with line ministries and regulatory bodies. International trade agreements, including the CP-TPP (effective January 2019) are also driving institutional reforms, including in criminal court, property rights, labor courts and insurance laws. Additional priorities are:



Source: Doing Business, World Bank.
1/ The ease of doing business score measures the gap between a particular economy's performance and the best practice. 0 represents the lowest and 100 represents the best performance.

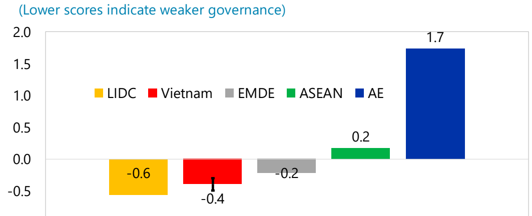
- *Modernizing institutions of macroeconomic management:* modernize the monetary framework; strengthen macro-fiscal analysis, accounting and reporting and modernizing the treasury and public debt management.

- *Banking*: strengthen risk-based supervision, manage SOCBs at arm's length, and broaden the application of international accounting and auditing standards.

- *SOEs:* require them to disclose timely financial statements based on improved accounting standards; conduct independent external audits in line with International Standards on Auditing; allow 100 percent foreign ownership in areas not critical to national security.

- *Regulation*: While the regulatory burden has lightened, implementation challenges remain. Barriers to private sector ownership should be further reduced. Regulatory entities must operate at arms-length.

- *Land*: ownership and leasing should aim to reduce its concentration in state hands and competitive land auctions should become the norm. A land use market should be developed, with greater clarity and simplification of regulations.



Sources: Worldwide Governance Indicators, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank), 2017.
1/ Score ranges from -2.5 (lowest) to 2.5 (highest). Use of these indicators should be considered carefully, as they are derived from perceptions-based data. The vertical line for Vietnam indicates the lower and upper bound estimate based on 90 percent confidence interval.

- *Data*: strengthen data provision for surveillance (including data on official international reserves, the International Investment Position, EBFs, and SOEs), seek closer alignment with international standards, and modernize data publication (e-GDDS) as a first step towards eventual subscription of the SDDS. Improve data quality on bank loan classification, disaggregated credit and banking sector and corporate exposures, and real estate markets.

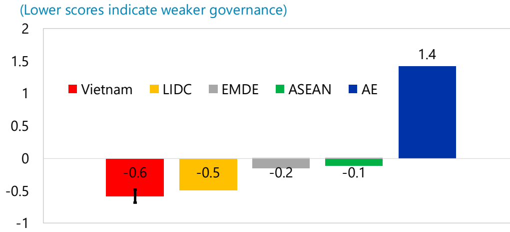
Box 1. Vietnam: Preparing for the Digital Economy

Embracing the digital revolution. New digital technologies are spreading fast in Vietnam, aided by the fast-growing wireless internet, including in fintech, mobility, and other aspects of the sharing economy. International technology companies have set up operations in the country, providing proof that Vietnam's economy has the potential to become even more diversified, complex and move up the quality ladder. In fintech, business developments are concentrated in electronic payments. The authorities recognize the opportunities but also the risks involved and have designated NAPAS (National Payment Corporation of Vietnam) to become the single hub for processing payments, which may pose private businesses at legal risks. Staff understands that the authorities are considering applying a new foreign ownership limit to payment servicers.

The opportunities and challenges of digitalization. Vietnam faces both opportunities and risks from the digital revolution now underway. The digital economy will continue to expand in coming years, spurred by 5G, a growing Internet of Things and blockchain. It will produce an explosion of data and techniques, including artificial intelligence systems, to harvest it and create new businesses. Vietnam's large internet and digital-savvy population is well placed to exploit the opportunities embedded in the new technologies. Its universities and polytechnics should work more closely with the business community and the government to upgrade curricula and ensure that graduates have STEM and other skills demanded by big tech. The regulatory regime should be flexible, balancing the need to experiment with (and learn from) adopting emerging digital platforms in payments, peer to peer lending and other fintech applications with consumer protection. Balanced regulation and streamlined, efficient procedures for obtaining licenses and upgrades of Vietnam's infrastructure should all help ensure that it remains a destination of choice for investors and entrepreneurs.

43. **Strengthening governance.** The government began tackling grand corruption in 2016 and significant sentences have been handed down in several high-level cases. The revamped 2018 anti-corruption law clarifies and enhances the legislative framework for combating corruption, by strengthening the declaration of income and wealth in government and SOEs, including public access to declarations. The linking (by end-2019) of databases on taxation, anti-money laundering, customs, and land transactions should facilitate asset verification. Stricter corporate governance regulations aligned with OECD best practices and tighter regulations to prevent related party transactions and collusion are likely to be introduced as part of the revised Securities Law to improve transparency and disclosure for listed enterprises. It is too early to see the effects of these efforts on corruption: the Control of Corruption

Vietnam: Control of Corruption, 2017 1/
(Lower scores indicate weaker governance)



Sources: Worldwide Governance Indicators, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank), 2017.
1/ Score ranges from -2.5 (lowest) to 2.5 (highest). Use of these indicators should be considered carefully, as they are derived from perceptions-based data. The vertical line for Vietnam indicates the lower and upper bound estimate based on 90 percent confidence interval.

score deteriorated since 2015 but the 2017 Provincial Governance and Public Administration Performance Index is more positive.[3]

Staff Position

44. Despite progress in recent years, additional efforts are needed to improve governance and fight corruption. Priorities reflect recommendations of IMF TA and echo suggestions in SM/18/125 (Appendix VI). Actions are needed along three fronts as follows.

Greater Fiscal Transparency and Stronger Public Investment Management

- Fiscal reporting and procurement systems must be strengthened, especially competitive bidding and e-procurement as suggested in the PIMA. Efforts to reduce irregularities in land acquisitions are a good step. Regarding the Public Investment Law, the authorities should aim for more clarification of roles between government agencies on project approval and between line ministries and provinces. A comprehensive PPP law that includes risk management and supervision should be finalized quickly.

Better Income and Asset Declarations, Stronger Judiciary and Legal Framework

- A first priority is to further improve asset declarations to align them with best practices, by making them more centralized, expanding the information covered and the disclosure requirement. The independence of the Government Inspectorate should be strengthened against undue political influence and abuse. The State Audit, Government Inspectorate, and ministerial and subnational Inspectorates should be granted more resources and their technical capacity improved (World Bank 2016).

- A second priority concerns strengthening the capacity of the judiciary to enforce contracts, strengthen legal interpretation, and facilitate resolution, restructuring and bankruptcy. The courts cannot handle the growing size and complexity of cases. Greater disclosure is needed of court judgments and case records; clarifying the roles of judges as arbiters rather than parties in cases; and enhancing the capacity for speedier resolution of cases.

- A third priority concerns improvements in the legal framework to incorporate safeguards against unfounded criminal prosecution of public officials for good faith performance of their duties. For instance, to ensure compliance with Basel Core Principle 1.5, the legislative framework for bank supervision should include legal protection for financial supervisory staff against lawsuits (IMF FSAP 2013). Similarly, legislative protection against criminal liability could be provided for tax officers.

[3] Perceptions-based indicators may reflect the biases of respondents.

Strengthening Anti-Money Laundering systems

- Staff welcomes the National Action Plan to strengthen the AML/CFT framework and execution. In line with FATF standards, the Plan envisages outreach on AML issues, training and regulatory capacity building, and closing regulatory gaps by November 2019. However, legislative gaps remain concerning customer due diligence for politically exposed persons. The FATF assessment which will get underway in 2019 will focus on the effective implementation of legislative provisions and institutional frameworks. Following the Asia Pacific Group (APG) assessment in October 2019, the IMF stands ready to assist the authorities in their efforts to make progress to address APG recommendations during the one-year observation period leading up to the 2020 FATF decision.

- Staff welcomes engagement with stakeholders in Vietnam, including the international community, think tanks, academia and the private sector, with interest in improving economic governance and fighting corruption.

Authorities' Views

45. Reform of economic institutions. The authorities underscored that they are committed to reforming Vietnam's economic institutions, complete the 2016–20 equitization plan and draw additional plans for 2021–30. They stressed that their commitment to institutional reforms is also driven by obligations under international trade agreements. Priorities include:

- Streamlining and simplifying taxation and administrative rules;

- Amending the land law to make land use and zoning more transparent and subject to streamlined procedures;

- Revising the Enterprise Law to reduce licensing requirements, remove duplicative procedures, and allow 100 percent FOLs in all but strategic sectors;

- Amending the Securities Law to focus supervision on larger firms.

- Reorienting the foreign direct investment strategy toward advanced sectors, are environmentally friendly and have strong linkages with domestic industry.

- Implementing reforms, in close collaboration with IMF technical assistance, to address data weaknesses and improve the dissemination of data, including for international reserves and the international investment position, consistent with their obligations under Article VIII, Section 5.

46. Anti-corruption campaign. The authorities are preparing implementing regulations and providing extensive training to declarants and inspectors related to the revised anti-corruption law and are moving to centralize the asset declaration registry. They expect implementation of the law to be challenging given the largely cash transactions, lack of registration of property and land use, and the need to upgrade technology and skills. The authorities are also preparing for the upcoming AML review by APG in October 2019 but extending the current AML law to domestically exposed persons is not under consideration. The authorities welcome IMF technical assistance to address concerns raised by the APG review.

STAFF APPRAISAL

47. **Resilient growth.** The economy remains resilient to date to rising trade tensions and heightened external risks, although the weaker external conditions are expected to lead to a soft landing of growth. Sound fundamentals, the authorities' commitment to macroeconomic stability and positive reform momentum are contributing to broad based, private sector-led and non-inflationary growth. Rural-urban migration and economic modernization continue, helping to raise wages and total factor productivity.

48. **External Sector Assessment.** The external position is substantially stronger than warranted by fundamentals and desirable policies. Removing distortions that inhibit investment and making the exchange rate more flexible within the band should help reduce the external imbalance. Over time, Vietnam's need for additional international reserves will decline as its monetary framework is modernized and its exchange rate becomes more flexible. In the meantime, over the next several years, it should continue gradual reserve accumulation.

49. **Fiscal sustainability.** The countercyclical tightening of fiscal policy in recent years has enabled Vietnam to lower government and PPG debt in relation to GDP and create some fiscal space. The authorities remain committed to further consolidating their public finances over the medium term. They are working closely with the Fund to improve fiscal management and policy. Broadening revenue bases and raising the quality of spending and of public financial management are priorities, especially building high quality infrastructure and protecting social spending. They need to create more fiscal space to meet longer term challenges arising from aging and climate change.

50. **Financial discipline and reform.** Vietnam's commitment to macroeconomic stability and reform extends to monetary and credit policies. Tighter limits on credit growth, the shift to retail banking, introduction of Basel II requirements and progress with bank recapitalization and the organic emergence of a capital market are all under way. These reforms are allowing Vietnam to strengthen its banks (long the system's Achilles heel) and improve the quality of intermediation without sacrificing growth. The modernization of the monetary framework is also under way. The authorities should finalize their plans to recapitalize SOCBs. The use of Basel II as an incentive mechanism to liberalize the financial system is welcome. Liberalization should go hand in hand with the creation of a modern macro-prudential system to replace the administrative allocation of credit.

51. **Structural reforms.** The reform drive needs to be broadened, deepened and accelerated to tackle the remaining barriers to investment. Priority areas include reforms to reduce the concentration of land ownership in state hands; accelerate the creation of high-quality infrastructure; further reductions in regulatory and licensing requirements; and reforms to tertiary and vocational education to prepare the economy for the new digital era.

52. Data and Statistics. The forthcoming revisions to national income and balance of payments data are welcome. They are based on new surveys and richer administrative sources of data. Fiscal accounting and reporting need to improve by compiling more detailed, timely and comprehensive fiscal data for the entire general government. The Fund is assisting in these efforts by providing technical services on data and statistics. Greater information sharing and transparency throughout the government and vis-a-vis the general public should be an integral part the effort to modernize institutions of economic management and will help the country reach full emerging market status.

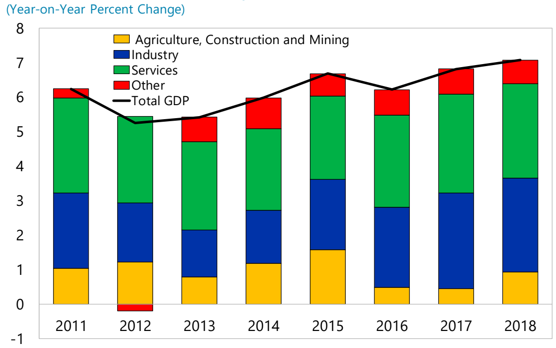
53. Governance. Vietnam's steps to strengthen economic governance and fight corruption are welcome. The authorities are working closely with the Fund on PIMA and AML/CFT issues. Further enhancements are needed to the new anti-corruption law to strengthen income and asset declarations and the legal framework. Greater transparency and data availability will help improve governance and fight corruption.

54. The staff recommends that the next Article IV Consultation take place on the standard 12- month cycle.

Figure 1. Vietnam: Robust Growth, Low Inflation

Economic growth has been strong, led by the service sector and industrial activity…

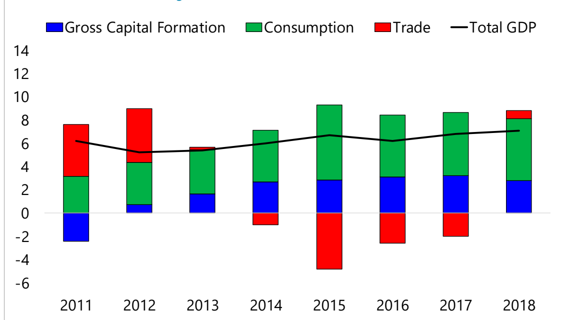
Contribution to GDP Growth by Economic Activities (2010 prices)
(Year-on-Year Percent Change)



Sources: National authorities; and IMF staff calculations.

…reflected in strong domestic demand.

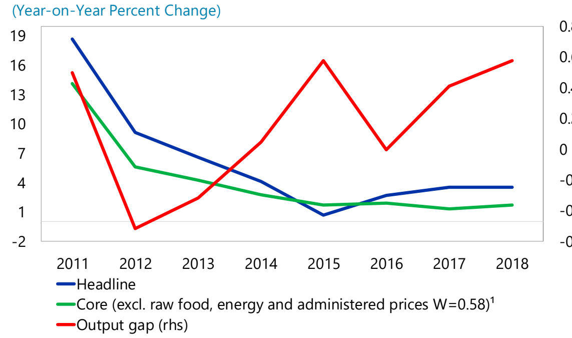
Contribution to GDP Growth by Expenditure (2010 prices)
(Year-on-Year Percent Change)



Sources: National authorities; and IMF staff calculations.

Headline inflation has remained at low levels…

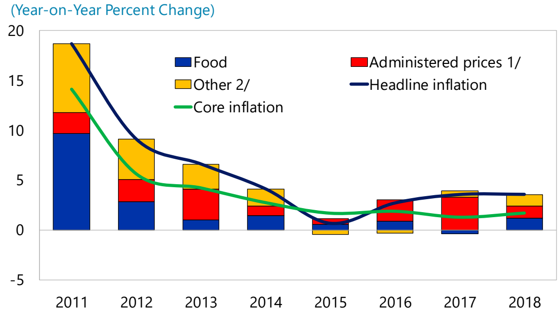
Inflation and Output Gap
(Year-on-Year Percent Change)



[1] W=2014 Weight
Sources: National authorities; and IMF staff calculations.

…and was mainly driven by food and administered prices.

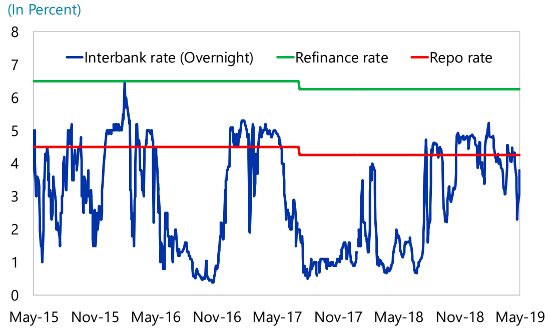
Vietnam: Contribution to Headline Inflation
(Year-on-Year Percent Change)



Sources: National authorities; and IMF staff calculations.
1/Includes education and health care services.
2/ Includes beverage, housing, garment, medicine, transport, post and telecom, education, culture and other goods.

Monetary policy has been tightened…

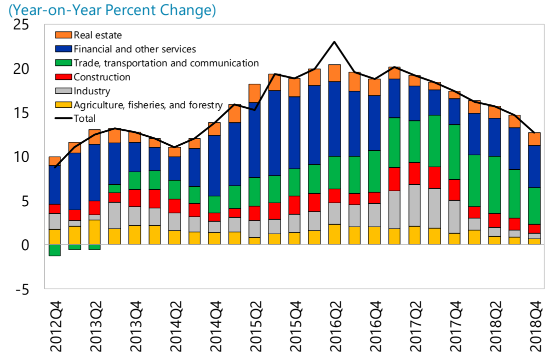
Vietnam: Interest Rates
(In Percent)



Sources: Vietnamese authorities; Bloomberg LP; and IMF staff estimates.

… and private sector credit growth has declined to below 13 percent y/y.

Contribution to Credit Growth
(Year-on-Year Percent Change)

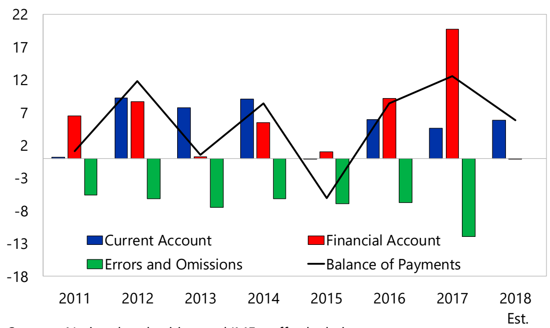


Sources: National authorities; and IMF staff calculations.

Figure 2. Vietnam: Strong Trade, FDI and Rising Reserves but Greater Cover Required

The balance of payments remained in surplus…

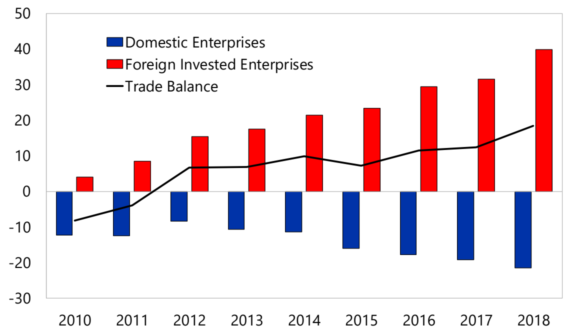
External Accounts
(In Percent of GDP)



Sources: National authorities; and IMF staff calculations.

Strong net exports from the FDI sector more than offset the trade deficit elsewhere in the economy.

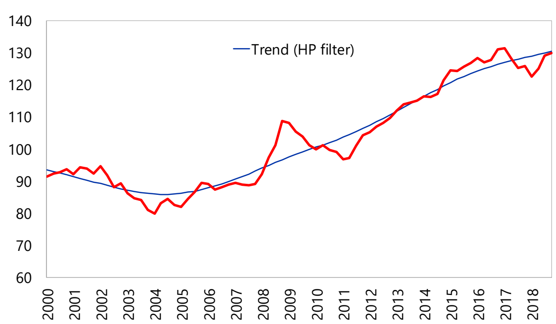
Trade Balance
(In Billions of USD)



Sources: National authorities; and IMF staff calculations.

The REER has resumed its appreciating trend.

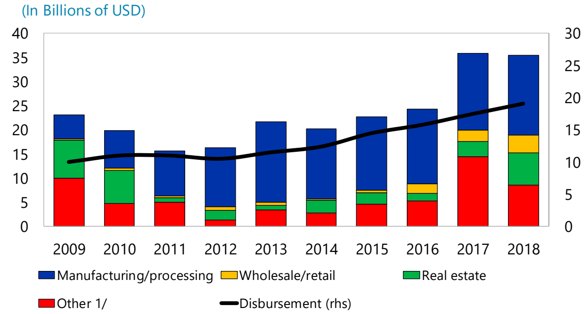
Vietnam: Real Effective Exchange Rate, 2000Q1—2018Q4
(2010=100)



Sources: INS; and IMF staff calculations.

FDI inflows remained strong, mainly focused in manufacturing and recently real estate.

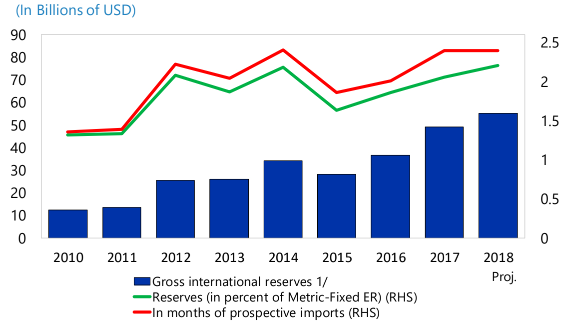
FDI Commitments and Disbursements
(In Billions of USD)



Source: National authorities; and IMF staff calculations.
1/Construction, Hotel and Restaurants, Mining, Agricultural, Forestry and Fishery, Electricity, Gas and AC production and other.

The strong external position permitted additional reserve accumulation, two way FX intervention…

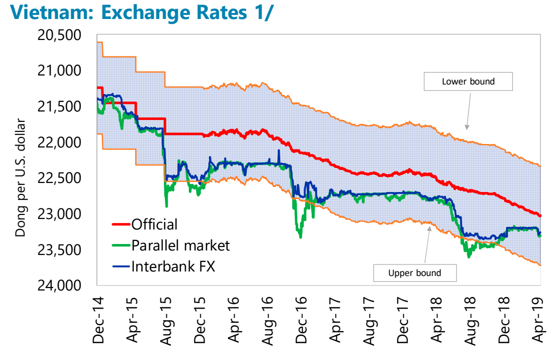
Reserves
(In Billions of USD)



Sources: National authorities; and IMF staff calculations.
1/Excludes government deposits.

…which limited the depreciation of the Dong against the U.S. dollar.

Vietnam: Exchange Rates 1/

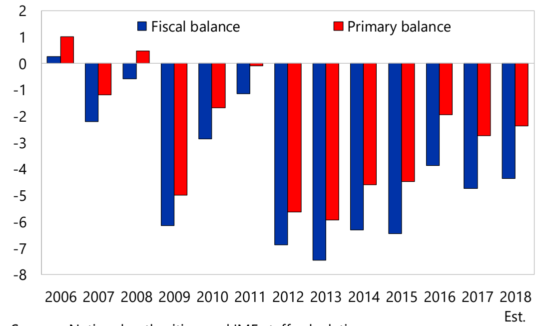


Sources: Vietnamese authorities; Bloomberg LP.
1/ An upward movement indicates an appreciation of the dong.

Figure 3. Vietnam: Fiscal Consolidation, Lower Public Debt

The fiscal position improved in 2018…

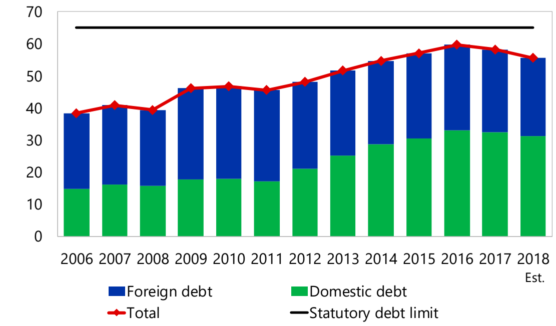
Fiscal Balance
(In Percent of GDP)



Sources: National authorities; and IMF staff calculations.

…contributing to lower public debt levels.

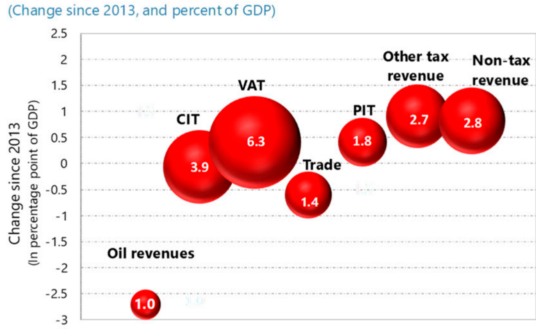
Public and Publicly Guaranteed Debt
(In Percent of GDP)



Sources: National authorities; and IMF staff calculations.

While tax revenue collections have improved over time…

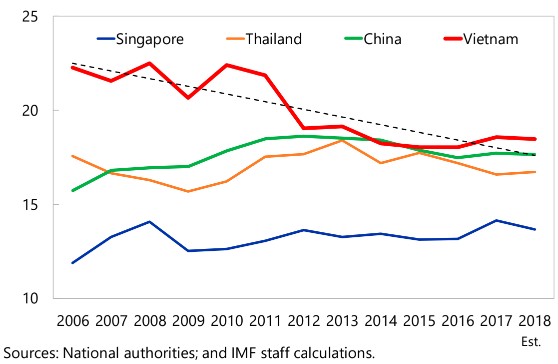
Revenue, 2018 1/
(Change since 2013, and percent of GDP)



1/ Size of the bubble represents the share of GDP.
Sources: National authorities; and IMF staff calculations.

…they remain on a downward trend.

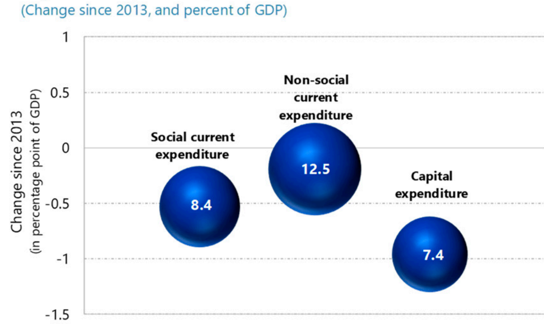
Tax Revenue
(In Percent of Fiscal Year GDP)



Sources: National authorities; and IMF staff calculations.

Public expenditure has been driven mainly by non-social current spending…

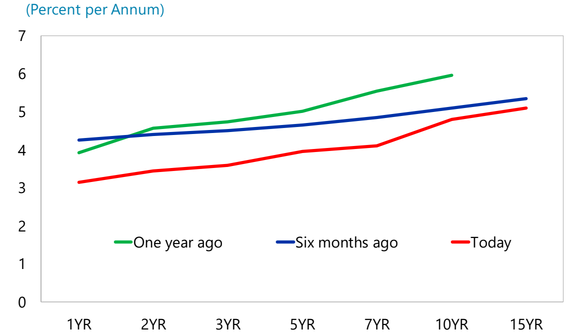
Expenditure, 2018 1/
(Change since 2013, and percent of GDP)



1/ Size of the bubble represents the share of GDP.
Sources: National authorities; and IMF staff calculations.

… although falling yields have moderated debt service costs.

Domestic Bond Yield Curve 1/
(Percent per Annum)

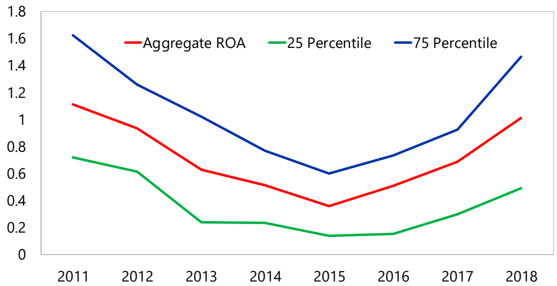


1/ Data as of May 10, 2019.
Sources: National authorities; and IMF staff calculations.

Figure 4. Vietnam: Strengthening the Financial Sector, Dealing with Weaknesses

The banking sector's profitability is improving…

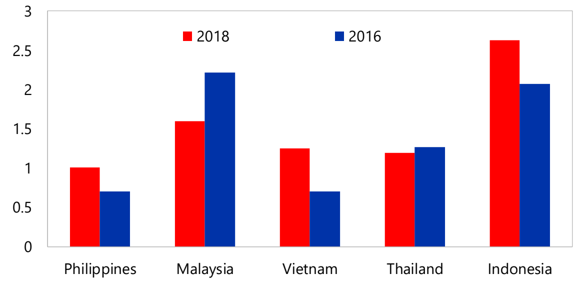
Vietnam Banks: Return on Assets
(In Percent)



Sources: Fitch Connect; and IMF staff calculations.
Note: Aggregate ROAs in Fitch Connect cover only large banks in Vietnam.

… but remains low by ASEAN standards…

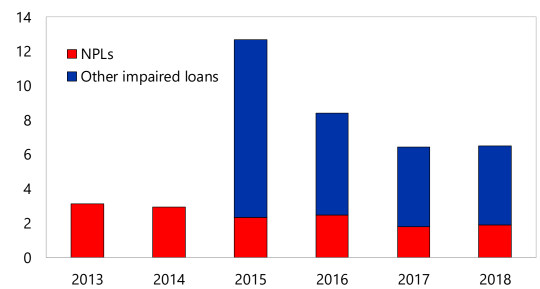
Regional Comparison: Return on Assets
(In Percent)



Source: Fitch Connect; and IMF staff calculations.
Note: The figure shows the aggregate ROAs in 2016 and 2018 for commercial banks, which are calculated on the basis of data available from Fitch Connect in each country.

… in part because of legacy NPLs in some banks.

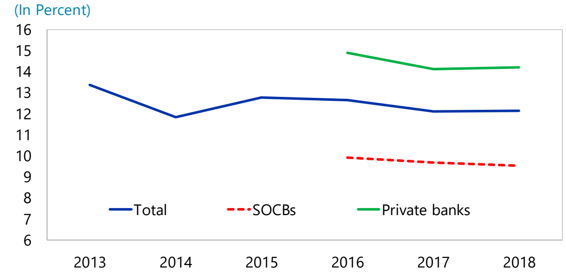
Bad Loan Ratios
(In Percent of Total Gross Loans)



Sources: Financial Soundness Indicators (FSI).
Note: Other impaired loans include a broader definition of NPLs such as those sold to the VAMC and loans previously restructured under Decision 780.

Capital adequacy ratios remain low in some state-owned commercial banks due to dividend payments to budget.

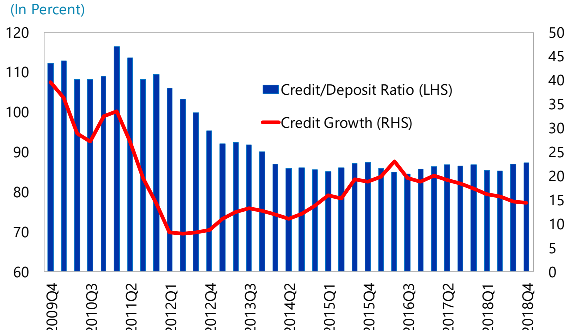
Capital Adequacy Ratios
(In Percent)



Sources: Financial Soundness Indicators (FSI).
Note: The capital adequacy ratio (CAR) covers the total banking system, and all the SOCBs respectively. The CAR for private sector banks is calculated from CARs for total banking system and SOCBs by assuming that the amount of risk-weighted assets are proportional to total assets.

Credit growth has subsided and continued to be funded by stable credit-deposit ratios…

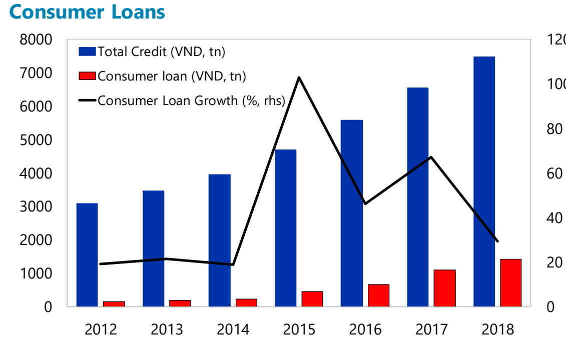
Credit to Deposit Ratio
(In Percent)



Source: National authorities; and IMF staff calculations.

… but the rise in higher-risk consumer lending may worsen asset quality in a downturn.

Consumer Loans

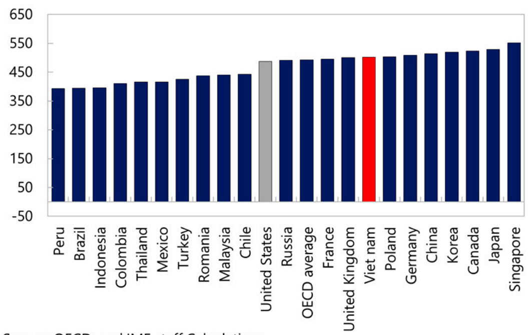


Sources: Saigon Securities Incorporation; and IMF staff calculation.
Note: Consumer loan data for the banking system is based on the report by Saigon Securities Corporation.

Figure 5. Vietnam: Competitiveness and Business Climate

A well-educated labor force and other strong fundamentals have helped attract FDI...

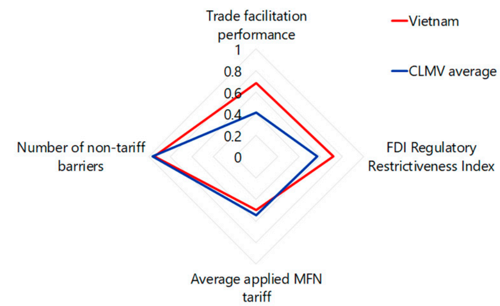
Pisa 2015 Score 1/



Source: OECD; and IMF staff Calculations.
1/ Average of pisa score in mathematics, reading and science.

... but there is room to reduce trade barriers ...

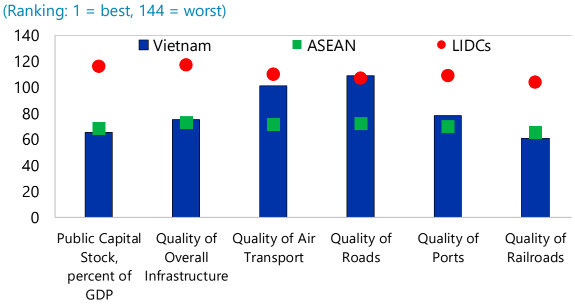
Overall Trade and FDI Regime
(Distance to frontier score)



Sources: WTO, World Tariff Profiles; OECD; World Bank; UNCTAD TRAINS database.

... and raise levels of the public capital stock...

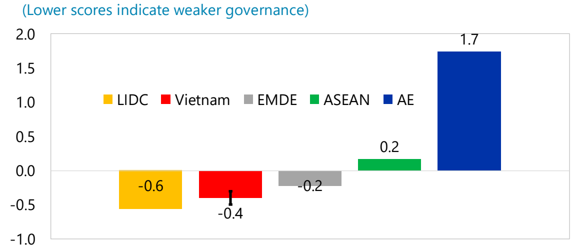
Capital Stock and Infrastructure Quality, Latest value available
(Ranking: 1 = best, 144 = worst)



Sources: IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook, World Development Indicators, IMF Investment and Capital Stock Dataset, and We Economic Forum.

...and raise the quality of regulations...

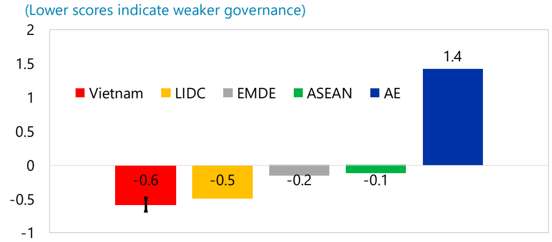
Regulatory Quality, 2017 1/
(Lower scores indicate weaker governance)



Sources: Worldwide Governance Indicators, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank), 2017.
1/ Score ranges from -2.5 (lowest) to 2.5 (highest). Use of these indicators should be considered carefully, as they are derived from perceptions-based data. The vertical line for Vietnam indicates the lower and upper bound estimate based on 90 percent confidence interval.

Perception of corruption and weak institutions...

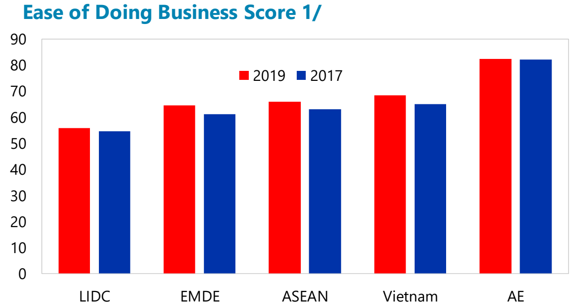
Control of Corruption, 2017 1/
(Lower scores indicate weaker governance)



Sources: Worldwide Governance Indicators, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank), 2017.
1/ Score ranges from -2.5 (lowest) to 2.5 (highest). Use of these indicators should be considered carefully, as they are derived from perceptions-based data. The vertical line for Vietnam indicates the lower and upper bound estimate based on 90 percent confidence interval.

...leave scope for further improving the business environment.

Ease of Doing Business Score 1/



Source: Doing Business, World Bank.
1/ The ease of doing business score measures the gap between a particular economy's performance and the best practice. 0 represents the lowest and 100 represents the best performance.

Table 1. Vietnam: Selected Economic Indicators, 2014–20 1/

	2014	2015	2016	Est. 2017	Projections 2018	2019	2020
Output							
Real GDP (percent change)	6.0	6.7	6.2	6.8	7.1	6.5	6.5
Prices (percent change)							
CPI (period average)	4.1	0.6	2.7	3.5	3.5	3.6	3.8
CPI (end of period)	1.8	0.6	4.7	2.6	3.0	3.7	3.8
Core inflation (end of period)	2.7	1.7	1.9	1.3	1.7	2.1	2.2
Saving and investment (in percent of GDP)							
Gross national saving	35.9	32.5	36.0	35.5	36.0	35.6	35.3
Gross investment	31.0	32.6	33.0	33.4	33.5	33.4	33.4
Private	18.6	20.2	20.7	21.5	22.4	22.6	22.7
Public	12.4	12.4	12.4	11.9	11.2	10.8	10.7
State budget finances (in percent of GDP) 2/							
Revenue and grants	22.2	23.8	24.0	24.5	24.5	23.4	23.3
Of which: Oil revenue	2.5	1.6	0.9	1.0	1.0	0.7	0.6
Expenditure	28.5	30.2	27.8	29.2	28.8	27.8	27.6
Expense	20.4	21.4	20.4	21.3	20.8	20.1	20.0
Net acquisition of nonfinancial assets	8.1	8.8	7.4	8.0	8.0	7.6	7.6
Net lending (+)/borrowing(-) 3/	-6.3	-6.4	-3.9	-4.7	-4.4	-4.4	-4.2
Net lending /borrowing including EBFs	…	…	…	-2.9	-2.6	-2.6	-2.6
Public and publicly guaranteed debt (end of period)	54.7	57.1	59.7	58.2	55.6	54.4	53.3
Money and credit (percent change, end of period)							
Broad money (M2)	17.7	16.2	18.4	15.0	12.4	15.5	14.9
Credit to the economy	13.8	18.8	18.8	17.4	12.7	13.7	13.1
Interest rates (in percent, end of period)							
Nominal three-month deposit rate (households) 4/	5.0	4.8	4.9	5.9	5.9	…	…
Nominal short-term lending rate (less than one year) 4/	8.5	7.2	7.2	8.7	8.7	…	…
Balance of payments (in percent of GDP, unless otherwise indicated)							
Current account balance (including official transfers)	4.9	-0.1	2.9	2.1	2.4	2.2	1.9
Exports f.o.b.	80.9	84.7	87.7	97.6	101.2	104.8	108.8
Imports f.o.b.	74.3	80.8	82.2	92.7	94.6	98.7	103.0
Capital and financial account 5/	3.0	0.5	4.6	9.0	0.0	2.0	2.2
Gross international reserves (in billions of U.S. dollars) 6/	34.3	28.3	36.7	49.2	55.3	66.2	77.7
In months of prospective GNFS imports	2.4	1.9	2.0	2.4	2.4	2.5	2.6
Total external debt (end of period)	38.3	42.0	44.8	49.0	46.0	47.2	47.5
Nominal exchange rate (dong/U.S. dollar, end of period)	21,200	21,951	22,372	22,709	23,175	...	...
Nominal effective exchange rate (end of period)	93.9	97.6	97.7	91.2	93.1	...	...
Real effective exchange rate (end of period)	124.7	129.8	134.0	126.2	131.0	...	...
Memorandum items:							
GDP (in trillions of dong at current market prices)	3,938	4,193	4,503	5,006	5,535	6,084	6,695
GDP (in billions of U.S. dollars)	185.8	191.3	201.3	220.4	241.3	260.5	282.4
Per capita GDP (in U.S. dollars)	2,047	2,086	2,172	2,353	2,551	2,728	2,929

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ The national accounts has been re-based to 2010 from 1994 by the authorities.

2/ Follows the format of the *Government Finance Statistics Manual 2001*. Large EBFs are outside the state budget but inside the general government (revenue amounting to 6-7 percent of GDP).

3/ Excludes net lending of Vietnam Development Bank and revenue and expenditure of Vietnam Social Security.

4/ Latest available for 2018.

5/ Incorporates a projection for negative errors and omissions going forward (i.e. unrecorded imports and short-term capital outlfows).

6/ Excludes government deposits.

Table 2. Vietnam: Balance of Payments, 2014–2020

(In billions of U.S. dollars, unless otherwise indicated)

					Projections		
	2014	2015	2016	2017	2018	2019	2020
Current account balance	9.1	-0.1	5.9	4.7	5.8	5.7	5.4
Trade balance	12.1	7.4	11.0	10.8	15.8	16.0	16.5
Exports, f.o.b.	150.2	162.0	176.6	215.1	244.0	273.0	307.3
Imports, f.o.b.	138.1	154.6	165.5	204.3	228.2	257.1	290.8
Nonfactor services	-3.5	-5.3	-4.5	-3.9	-4.2	-4.0	-3.7
Receipts	11.0	11.3	12.3	13.1	14.5	16.3	18.1
Payments	14.5	16.5	16.8	17.0	18.7	20.2	21.8
Investment income	-8.8	-10.0	-8.6	-10.8	-14.8	-15.7	-17.1
Receipts	0.3	0.4	0.7	0.7	0.8	0.8	0.9
Payments	9.2	10.4	9.2	11.5	15.5	16.5	18.0
Transfers	9.3	7.7	8.0	8.5	9.0	9.4	9.8
Private (net)	8.8	7.4	7.7	8.3	8.8	9.2	9.6
Official (net)	0.5	0.3	0.3	0.2	0.2	0.2	0.2
Capital and financial account balance	5.5	1.0	9.2	19.8	0.0	5.2	6.1
Direct investment (net)	8.1	10.7	11.6	13.6	15.0	16.2	17.3
Of which: Foreign direct investment in Vietnam	9.2	11.8	12.6	14.1	15.5	16.7	17.9
Portfolio investment	0.1	-0.1	0.2	1.9	3.0	3.5	4.0
Medium- and long-term loans	5.4	4.6	3.2	4.3	4.1	3.7	3.4
Disbursements	9.8	9.8	8.7	13.7	14.4	15.1	15.9
Amortization	4.4	5.2	5.5	9.4	10.4	11.4	12.5
Short-term capital 1/	-8.0	-14.2	-5.8	0.0	-22.0	-18.2	-18.5
Change in net foreign assets	-9.1	-15.0	-5.2	-6.5	-9.1	-9.1	-10.0
Of which: Commercial banks	-1.5	-5.3	2.1	-4.1	-5.7	-5.7	-6.3
Trade credit (net)	1.0	0.8	-0.6	6.4	0.8	0.8	0.9
Other short-term capital 1/	…	…	…	…	-13.8	-10.0	-9.5
Errors and omissions	-6.2	-6.9	-6.8	-11.9	0.0	0.0	0.0
Overall balance	8.4	-6.0	8.4	12.5	6.0	10.9	11.6
Memorandum items:							
Gross international reserves 2/	34.3	28.3	36.7	49.2	55.3	66.2	77.7
In months of prospective GNFS imports	2.4	1.9	2.0	2.4	2.4	2.5	2.6
Current account balance (in percent of GDP)	4.9	-0.1	2.9	2.1	2.4	2.2	1.9
Export value (percent change)	13.8	7.9	9.0	21.8	13.4	11.9	12.6
Import value (percent change)	12.0	12.0	7.0	23.4	11.7	12.6	13.1
External debt	71.2	80.1	90.2	107.9	110.0	121.9	133.3
In percent of GDP 3/	38.3	42.0	44.8	49.0	46.0	47.2	47.5
GDP	185.8	191.3	201.3	220.4	241.3	260.5	282.4

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ Incorporates a projection for negative errors and omissions going forward (i.e. unrecorded imports and US dollar currency holdings by residents outside the formal financial sector).

2/ Excludes government deposits.

3/ Uses interbank exchange rate.

Table 3. Vietnam: Medium-Term Projections, 2014–2024

				Est.	Projections						
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Output					(Percent change)						
Real GDP	6.0	6.7	6.2	6.8	7.1	6.5	6.5	6.5	6.5	6.5	6.5
Prices											
CPI (period average)	4.1	0.6	2.7	3.5	3.5	3.6	3.8	3.8	3.9	4.0	4.0
CPI (end of period)	1.8	0.6	4.7	2.6	3.0	3.7	3.8	3.9	3.9	4.0	4.0
GDP deflator	3.7	-0.2	1.1	4.1	3.3	3.2	3.3	3.3	3.5	3.7	4.0
Saving and investment					(In percent of GDP, unless otherwise indicated)						
Gross national saving	35.9	32.5	36.0	35.5	36.0	35.6	35.3	35.3	35.0	34.9	34.9
Gross investment	31.0	32.6	33.0	33.4	33.5	33.4	33.4	33.6	33.6	33.7	33.9
Private investment	18.6	20.2	20.7	21.5	22.4	22.6	22.7	23.0	23.1	23.3	23.5
Public investment	12.4	12.4	12.4	11.9	11.2	10.8	10.7	10.6	10.5	10.4	10.3
State budget finances 1/											
Revenue and grants	22.2	23.8	24.0	24.5	24.5	23.4	23.3	23.2	23.2	23.2	23.1
Expenditure	28.5	30.2	27.8	29.2	28.8	27.8	27.6	27.1	26.9	26.7	26.5
Expense	20.4	21.4	20.4	21.3	20.8	20.1	20.0	19.6	19.4	19.3	19.1
Net acquisition of nonfinancial assets	8.1	8.8	7.4	8.0	8.0	7.6	7.6	7.5	7.5	7.4	7.4
Net lending (+)/borrowing(-) 2/	-6.3	-6.4	-3.9	-4.7	-4.4	-4.4	-4.2	-3.9	-3.7	-3.5	-3.4
Net lending /borrowing including EBFs	…	…	…	-2.9	-2.6	-2.6	-2.6	-2.4	-2.3	-2.3	-2.4
Non-oil primary balance	-7.1	-6.1	-2.8	-3.7	-3.4	-3.0	-2.7	-2.5	-2.2	-1.9	-1.8
Public and publicly guaranteed debt (end of period)	54.7	57.1	59.7	58.2	55.6	54.4	53.3	52.5	51.5	50.4	49.3
Balance of payments											
Current account balance	4.9	-0.1	2.9	2.1	2.4	2.2	1.9	1.7	1.4	1.2	1.0
Exports f.o.b.	80.9	84.7	87.7	97.6	101.2	104.8	108.8	113.6	118.6	123.8	129.3
Imports f.o.b.	74.3	80.8	82.2	92.7	94.6	98.7	103.0	107.9	113.2	118.6	124.3
Capital and financial account (net)	3.0	0.5	4.6	9.0	0.0	2.0	2.2	2.5	2.6	2.7	3.0
Gross international official reserves (in billions of U.S. dollars)	34.3	28.3	36.7	49.2	55.3	66.2	77.7	90.5	103.8	117.8	133.6
In months of prospective GNFS imports	2.4	1.9	2.0	2.4	2.4	2.5	2.6	2.7	2.7	2.7	2.8
Total external debt (in billions U.S. dollars)	71.2	80.1	90.2	107.9	110.0	121.9	133.3	147.6	164.4	184.1	206.1
In percent of GDP	38.3	42.0	44.8	49.0	46.0	47.2	47.5	48.7	50.0	51.6	53.2
Memorandum items:											
Nominal GDP (in trillions of dong)	3,938	4,193	4,503	5,006	5,535	6,084	6,695	7,367	8,121	8,970	9,932
Nominal GDP (in billions of U.S. dollars)	185.8	191.3	201.3	220.4	241.3	260.5	282.4	305.8	331.3	359.6	391.0
Per capita GDP (in U.S. dollars)	2,047	2,086	2,172	2,353	2,551	2,728	2,929	3,142	3,374	3,629	3,913

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ Follows the format of the *Government Finance Statistics Manual 2001*. Large EBFs are outside the state budget but inside the general government (revenue amounting to 6-7 percent of GDP).

2/ Excludes net lending of Vietnam Development Bank and revenue and expenditure of Vietnam Social Security.

Table 4a. Vietnam: Consolidated State Budgetary Operations, 2013–2019 1/

(In trillions of dong)

					Estimate	Budget	Staff Estimate	Budget	Staff Estimate
	2013	2014	2015	2016 2/	2017	2018	2018	2019	2019
				(In trillions of dong)					
Total revenue and grants	827	876	996	1080	1227	1254	1356	1360	1423
Tax revenue	685	717	756	812	929	1027	1022	1114	1106
Oil revenues	120	100	68	40	50	36	55	45	43
CIT	91	73	50	28	36	25	38	32	32
Natural resource tax	30	27	18	12	14	11	17	13	12
Non-oil tax revenues	565	617	689	772	879	992	967	1069	1063
PIT	47	48	57	68	79	97	94	113	107
CIT	141	135	150	161	181	218	213	246	241
VAT	209	241	252	272	314	355	344	373	375
Trade	78	96	99	96	97	91	87	81	81
Others	91	98	131	175	207	231	228	256	258
Grants	11	11	12	8	8	5	8	4	3
Other revenue	131	147	228	260	290	221	325	242	314
Expenditure	1094	1123	1266	1254	1463	1511	1596	1633	1690
Expense	773	804	895	920	1064	1121	1153	1213	1225
Interest	54	67	82	87	99	113	110	125	125
Other expense	719	737	813	833	965	1009	1044	1054	1067
Of which: Wages 3/	…	…	…	…	453	504	504	541	541
Net acquisition of non-financial assets	321	319	371	334	399	390	443	421	464
Net lending (+)/borrowing (-)	-267	-248	-270	-174	-236	-257	-241	-274	-267
Net incurrence of liabilities	267	248	270	174	135	257	241	259	267
Net incurrence of financial liabilities	264	322	218	258	191	169	152	228	233
Domestic	186	225	152	206	141	120	104	171	173
Securities	132	137	105	…	…	…	…	…	…
Loans	55	92	47	…	…	…	…	…	…
Foreign	78	97	67	52	50	49	49	59	61
Disbursement	105	136	89	86	80	69	69	84	86
Amortization	27	39	22	33	30	36	36	42	42
Net acquisition of financial assets	3	-74	51	-85	-56	88	88	31	34
Of which: Privitazation receipts	…	…	…	30	60	65	65	50	50
Memorandum items:									
VSS net lending/borrowing	…	…	…	…	76	…	102	…	107
EBF revenue (net government transfers)	…	…	…	…	352	…	376	…	413
EBF expenditure (net government transfers)	…	…	…	…	251	…	274	…	307
Net lending/borrowing including EBFs	…	…	…	…	-146	…	-142	…	-161
Public and publicly guaranteed debt	51.7	54.7	57.1	59.7	58.2	55.6	55.6	54.4	54.4
Primary balance	-5.9	-4.6	-4.5	-1.9	-2.7	-2.6	-2.4	-2.4	-2.3
Non-oil primary balance	-9.3	-7.0	-6.1	-2.8	-3.7	-3.3	-3.4	-3.2	-3.0
Cyclically Adjusted Primary Balance	-5.9	-4.6	-4.6	-2.8	-3.0	…	-2.5	…	-2.3
Nominal GDP (in trillions of dong)	3584.3	3937.9	4192.9	4502.7	5006.0	5535.3	5535.3	6084.0	6084.0

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ Government Finance Statistics 2001 presentation. The baseline projections include assumptions of lower trade-related tax revenue due to international trade agreements, gradual improvements in tax collection, and current plans for SOE equitization/divestment. Figures consolidate central and provincial government accounts, but exclude net lending of Vietnam Development Bank and revenue and exenditure of Vietnam Social Security and other extra-budgetary funds.

2/ Expenditure includes 66 trn of 2015 revenue overperformance by local governments equally split between capital and current expenditure.

3/ Wages are staff estimates.

Table 4b. Vietnam: Consolidated State Budgetary Operations, 2013–2019 1/

(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016 2/	Estimate 2017	Budget 2018	Staff Estimate 2018	Budget 2019	Staff Estimate 2019
	(In percent of GDP, unless otherwise indicated)								
Total revenue and grants	23.1	22.2	23.8	24.0	24.5	22.6	24.5	22.3	23.4
Tax revenue	19.1	18.2	18.0	18.0	18.6	18.6	18.5	18.3	18.2
Oil revenues	3.4	2.5	1.6	0.9	1.0	0.6	1.0	0.7	0.7
CIT	2.5	1.8	1.2	0.6	0.7	0.4	0.7	0.5	0.5
Natural resource tax	0.8	0.7	0.4	0.3	0.3	0.2	0.3	0.2	0.2
Non-oil tax revenues	15.8	15.7	16.4	17.1	17.6	17.9	17.5	17.6	17.5
PIT	1.3	1.2	1.4	1.5	1.6	1.8	1.7	1.9	1.8
CIT	3.9	3.4	3.6	3.6	3.6	3.9	3.9	4.0	4.0
VAT	5.8	6.1	6.0	6.0	6.3	6.4	6.2	6.1	6.2
Trade	2.2	2.4	2.4	2.1	1.9	1.6	1.6	1.3	1.3
Others	2.5	2.5	3.1	3.9	4.1	4.2	4.1	4.2	4.2
Grants	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.0
Other revenue	3.7	3.7	5.4	5.8	5.8	4.0	5.9	4.0	5.2
Expenditure	30.5	28.5	30.2	27.8	29.2	27.3	28.8	26.8	27.8
Expense	21.6	20.4	21.4	20.4	21.3	20.3	20.8	19.9	20.1
Interest	1.5	1.7	2.0	1.9	2.0	2.0	2.0	2.1	2.1
Other expense	20.1	18.7	19.4	18.5	19.3	18.2	18.9	17.3	17.5
Of which: Wages	...	...	...	...	9.0	9.1	9.1	8.9	8.9
Net acquisition of non-financial assets	9.0	8.1	8.8	7.4	8.0	7.0	8.0	6.9	7.6
Net lending (+)/borrowing (-)	-7.4	-6.3	-6.4	-3.9	-4.7	-4.6	-4.4	-4.5	-4.4
Net incurrence of liabilities	7.4	6.3	6.4	3.9	2.7	4.6	4.4	4.3	4.4
Net incurrence of financial liabilities	7.4	8.2	5.2	5.7	3.8	3.1	2.8	3.8	3.8
Domestic	5.2	5.7	3.6	4.6	2.8	2.2	1.9	2.8	2.8
Securities	3.7	3.5	2.5	...	...	...	...	...	...
Loans	1.5	2.3	1.1	...	...	...	...	...	...
Foreign	2.2	2.5	1.6	1.2	1.0	0.9	0.9	1.0	1.0
Disbursement	2.9	3.5	2.1	1.9	1.6	1.2	1.2	1.4	1.4
Amortization	0.8	1.0	0.5	0.7	0.6	0.7	0.7	0.7	0.7
Net acquisition of financial assets	0.1	-1.9	1.2	-1.9	-1.1	1.6	1.6	0.5	0.6
Of which: Privitazation receipts	...	...	...	0.7	1.2	1.2	1.2	0.8	0.8
Memorandum items:									
VSS net lending/borrowing	...	...	...	...	1.5	...	1.9	...	1.8
EBF revenue (net government transfers)	...	...	...	...	7.0	...	6.8	...	6.8
EBF expenditure (net government transfers)	...	...	...	...	5.0	...	4.9	...	5.1
Net lending/borrowing including EBFs	...	...	...	...	-2.9	...	-2.6	...	-2.6
Public and publicly guaranteed debt	51.7	54.7	57.1	59.7	58.2	55.6	55.6	54.4	54.4
Primary balance	-5.9	-4.6	-4.5	-1.9	-2.7	-2.6	-2.4	-2.4	-2.3
Non-oil primary balance	-9.3	-7.0	-6.1	-2.8	-3.7	-3.3	-3.4	-3.2	-3.0
Cyclically Adjusted Primary Balance	-5.9	-4.6	-4.6	-2.8	-3.0	...	-2.5	...	-2.3
Nominal GDP (in trillions of dong)	3,584	3,938	4,193	4,503	5,006	5,535	5,535	6,084	6,084

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ Government Finance Statistics 2001 presentation. The baseline projections include assumptions of lower trade-related tax revenue due to international trade agreements, gradual improvements in tax collection, and current plans for SOE equitization/divestment. Figures consolidate central and provincial government accounts, but exclude net lending of Vietnam Development Bank and revenue and exenditure of Vietnam Social Security and other extra-budgetary funds.

2/ Expenditure includes 66 trn of 2015 revenue overperformance by local governments equally split between capital and current expenditure.

3/ Wages are staff estimates.

Table 5. Vietnam: Monetary Survey, 2014–2020 1/

(In trillions of Dong, unless otherwise indicated)

	2014	2015	2016	2017	2018	Projections 2019	2020
Net foreign assets	826	836	949	1,264	1,540	1,964	2,420
State Bank of Vietnam (SBV)	722	614	806	1,097	1,263	1,547	1,847
Commercial banks	104	222	143	167	277	418	574
Net domestic assets	4,353	5,184	6,177	6,930	7,672	8,672	9,797
Domestic credit	4,480	5,381	6,307	7,102	7,852	8,906	10,055
Net claims on government	530	689	732	556	473	514	560
SBV	7	83	31	-10	-97	…	…
Credit institutions	523	606	701	566	570	…	…
Credit to the economy	3,950	4,693	5,575	6,546	7,379	8,393	9,495
Claims on state-owned enterprises (SOEs)	644	723	741	533	473	…	…
Claims on other sectors	3,306	3,970	4,834	6,014	6,906	…	…
In dong	3,458	4,267	5,127	6,054	6,911	…	…
In foreign currency	491	425	448	492	468	…	…
By state-owned banks (SOCBs)	1,850	2,304	2,723	3,174	3,523	…	…
By non-SOCBs	2,100	2,389	2,852	3,372	3,856	…	…
Other items net	-127	-198	-129	-172	-180	-234	-258
Total liquidity (M2)	5,179	6,020	7,126	8,195	9,212	10,636	12,217
Dong liquidity	4,613	5,370	6,505	7,539	8,460	…	…
Deposits	3,988	4,643	5,654	6,561	7,375	…	…
Currency outside banks	625	727	851	978	1,085	…	…
Foreign currency deposits	566	650	621	656	752	…	…
Memorandum items:							
Money multiplier 2/	6.3	6.1	6.4	6.1	6.4	6.4	6.4
Velocity	0.8	0.7	0.6	0.6	0.6	0.6	0.5
Reserve money (year-on-year percent change)	18.7	19.3	12.8	20.4	6.9	16.2	15.8
Liquidity (M2; year-on-year percent change)	17.7	16.2	18.4	15.0	12.4	15.5	14.9
Currency/deposits (in percent)	13.7	13.7	13.6	13.6	13.4	…	…
Credit/deposits (total, in percent)	86.7	88.7	88.9	90.7	90.8	89.4	88.1
Credit/deposits (dong, in percent)	86.7	91.9	90.7	92.3	93.7	…	…
Credit/deposits (foreign currency, in percent)	86.8	65.5	72.2	75.1	62.3	…	…
Credit to the economy							
Total (in percent of GDP)	100.3	111.9	123.8	130.8	133.3	137.9	141.8
Total (year-on-year percent change)	13.8	18.8	18.8	17.4	12.7	13.7	13.1
In dong (year-on-year percent change)	14.9	23.4	20.2	18.1	14.2	…	…
In FC (year-on-year percent change)	6.9	-13.4	5.2	10.0	-5.0	…	…
In FC at constant exchange rate (year on year percent change)	6.0	-16.3	3.1	8.3	-6.2	…	…
To SOEs (year-on-year percent change)	12.5	12.3	2.6	-28.1	-11.3	…	…
To other sectors (year-on-year percent change)	14.1	20.1	21.7	24.4	14.8	…	…
To SOEs (percent of total)	16.3	15.4	13.3	8.1	6.4	…	…
Dollarization							
Foreign currency deposits/total deposits (in percent)	12.4	12.3	9.9	9.1	9.3	…	…
Foreign currency loans/total loans (in percent)	12.4	9.1	8.0	7.5	6.3	…	…
Banks' net foreign exchange position (millions of U.S. dollars) 3/	1,372	-106	-1,347	151	-274.8	…	…
Government deposits (in percent of GDP)	2.3	1.6	2.5	6.2	8.3	…	…
Nominal GDP (in trillions of dong)	3,938	4,193	4,503	5,006	5,535	6,084	6,695

Sources: SBV; and IMF staff estimates and projections.

1/ Includes the SBV and deposit-taking credit institutions.

2/ M2 over reserve money.

3/ At interbank exchange rate; excludes SBV credit to credit institutions.

Table 6. Vietnam: Financial Soundness Indicators, 2013–18 1/

(In Percent)

	2013	2014	2015	2016	2017	2018
Regulatory Capital to Risk-Weighted Assets	13.4	11.8	12.8	12.6	12.1	12.1
Regulatory Tier 1 Capital to Risk-Weighted Assets	12.1	10.6	10.1	9.4	8.8	n.a.
Non-performing Loans Net of Provisions to Capital	12.8	14.2	11.0	11.4	10.7	n.a.
Non-performing Loans to Total Gross Loans 2/	3.1	2.9	2.3	2.5	1.8	1.9
Return on Assets 3/	0.5	0.3	0.4	0.5	0.6	0.7
Return on Equity 3/	5.8	3.2	5.4	6.6	8.3	9.8
Interest Margin to Gross Income	73.4	69.4	74.4	72.3	70.2	n.a.
Non-interest Expenses to Gross Income	55.1	56.7	55.8	55.3	51.0	n.a.
Liquid Assets to Total Assets (Liquid Asset Ratio)	13.0	15.5	13.2	13.2	12.7	n.a.

Source: Financial Soundness Indicators (FSI)

1/ Depository corporations only

2/ A more broadly defined NPL ratio, which includes NPLs sold to VAMC and loans previously restructured under Decision 780, is 6.5 percent of total loans as of December 2018.

3/ The values for 2018 is based on those until 2018Q3.

Appendix I. Risk Assessment Matrix

Risk	Likelihood of Risk	Impact	Policies to Minimize Impact
External Risks			
Sharp tightening of global financial conditions due to market expectation of US monetary policy	*L*	*M:* Decline in financial market confidence, capital outflows (including a reemergence of dollarization) with pressure on the exchange rate and reserves, stock market correction and tightening of liquidity conditions, increase in sovereign yields, pressure on banks with weak balance sheets	Tighten monetary policy and allow exchange rate flexibility, with judicious currency intervention to avoid excessive volatility and continue building reserves. The exchange rate band may need to be re-centered if there is a shift in fundamentals. Strengthen bank balance sheets to improve resilience. Modernize the monetary framework using inflation as a nominal anchor. Accelerate growth friendly fiscal consolidation to create more fiscal space and improve the quality and quantity of public investment and continue structural reforms to support FDI.
Weaker-than-expected global growth (US, China, Europe)	*M/M/H*	*H:* Decline in growth due to weaker export growth, FDI, and remittances. Pressures on the exchange rate and international reserves. Deterioration in public sector and bank balance sheets.	Allow greater exchange rate flexibility, move toward using inflation as a nominal anchor. Accelerate financial sector, SOE, and structural reforms to strengthen balance sheets, preserve investor confidence regarding the long-term prospects of the domestic economy, build resilience. Undertake fiscal rebalancing to support growth and public investment while ensuring debt sustainability.
Rising protectionism and retreat from multilateralism	*H*	*M:* Weaker export growth and FDI; supply chains could be interrupted. However, Vietnam could benefit from trade and investment diversion from the region.	Rapid implementation of CPTPP and FTAs with the EU, Eurasian Economic Union, and Korea. Deepen regional trade integration. Strengthen competitiveness and the business climate through accelerated SOE, structural, and banking sector reforms. Further improve the climate for FDI by increasing foreign ownership limits, revamping tertiary education, reforming land use, and improving the regulatory framework and governance.
Cyber-attacks on critical global infrastructure and institutions that undermine international payment systems and disrupt the flow of goods and services	*M*	*H:* Vietnam's high internet penetration and highly open economy make it vulnerable to global cyberattacks. Trade, financial market conditions and economic growth could all be adversely affected for a time.	Build public and private sector buffers, strengthen financial stability and institutions, improve domestic business and investment climate to better weather disruptions from cyber-attacks. Further strengthen resilience to, and awareness about, cyber security risks
Domestic Risks			
Low quality fiscal consolidation	*M*	*M:* Weaker medium-term productivity and output growth, higher sovereign yields, crowding out complicate debt dynamics and impact on bank balance sheets. Lower investor confidence and capital flight create exchange rate pressures.	Strengthen revenues by improving tax administration, introducing a property tax. Curtail non-essential spending, reduce wage bill by implementing civil service reform, improve quality of investment spending. Use SOE equitization receipts to help finance the budget, recapitalize state owned banks, and buy back debt, but this should not substitute for structural consolidation. Improve the quality, comprehensiveness and transparency of fiscal statistics to enable better policies.
Continued reliance on credit targets	*H*	*H:* Excessive risk taking exacerbates weaknesses in bank balance sheets. Credit misallocation gives rise to economic inefficiencies, reduces productivity and growth and creates an adverse sovereign-macroeconomic-financial feedback loop.	Continue reducing credit growth targets and phase them out over the medium-term and better align credit growth with nominal GDP growth to reduce the credit gap and reduce leverage. Accelerate NPL resolution and recapitalization of systemically important banks, resolve small unviable banks, strengthen safety nets. Monitor vulnerabilities and proactively manage risks to prevent excessive risk taking by banks. Make progress on developing a macroprudential framework.
Climate change and sustainable development	*H*	*H:* Vietnam is among the top ten countries affected by air pollution. By 2100, climate change could impact more than 12 percent of the population and reduce growth by 10 percent.	Lower the intensity of fossil fuels by raising the contribution of renewable energy. Provide stronger incentives for green growth through taxation of fossil fuels that fully price environmental externalities. Invest in climate resilient infrastructure. Shift to autonomous, electric, shared vehicles to reduce congestion and pollution in cities. Improve government capacity to coordinate technological change and promote green growth.

"L" =Low; "M" =Medium; "H" =High. The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

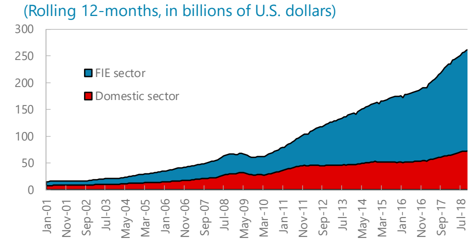
Appendix II. External Assessment[1]

The external position is substantially stronger than warranted by fundamentals and desirable policies. The current account (CA) gap is 6.4 percent of GDP and the exchange rate is undervalued by 8.4 percent, reflecting distortions still prevalent in Vietnam's economy which discourage investment in the domestic private sector. The CA gap should be addressed through more ambitious structural and financial sector reforms that strengthen private investment; protecting public investment and improving its efficiency while pursuing fiscal consolidation; and allowing greater two-way exchange rate flexibility to reduce the need to build buffers.

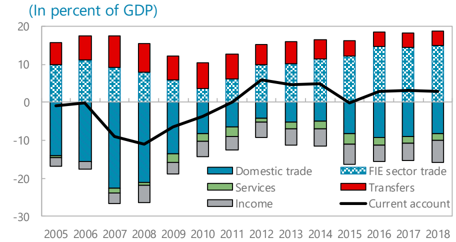
1. The current account position reflects a dual and segmented economy. A competitive FDI manufacturing sector generates a large trade surplus (15 percent of GDP), dominated by electronics multinationals and apparel producers engaged in processing and final assembly. Vietnam is becoming highly integrated into the global supply chain—both forward and backward linkages—while moving up the value chain, mainly in high-tech manufacturing. The domestic non-FDI sector (many SMEs, agriculture, tradable goods producers, including SOEs and domestic private firms) runs a trade deficit of 8.3 percent of GDP. Productivity in this sector is low (20 percent of that of the FDI sector), and exports are dominated by agricultural commodities and oil. Slow SOE reform progress, barriers faced by SMEs to reach economies of scale and credit misallocation and weaknesses in financial intermediation impede the development of a productive and vibrant economy outside the FDI sector despite rapid growth.

2. Investment has declined during the last decade while saving has remained high. Gross capital formation has been below most countries in the region. Excluding the FDI sector, investment has fallen by 10 percentage points, to 25 percent of GDP. This partly reflects cutbacks in SOE capital formation in heavy industries and barriers to the development of private manufacturing firms and SMEs, as well as declining public investment. Saving has remained at about 35 percent of GDP, which is high relative to peers, reflecting ineffective financial intermediation of high profits in the FDI sector into productive investment opportunities in the domestic economy because of foreign ownership limits and weaknesses in the banking system.

Vietnam: Exports–Domestic and FIE Sector, Jan.01–Dec.18
(Rolling 12-months, in billions of U.S. dollars)

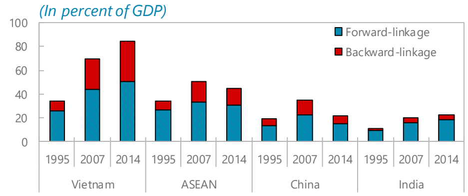


Vietnam: Current Account Balance, 2005–18
(In percent of GDP)



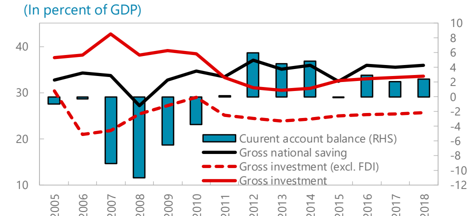
Sources: Vietnamese authorities; and IMF staff estimates.

Vietnam: Participation in Global Value Chains
(In percent of GDP)



Sources: TiVa database; and IMF staff calculations.
ASEAN includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam. Forward linkages are domestically produced intermediates to be used in third countries, and backward linkages are foreign value-added in domestic exports.

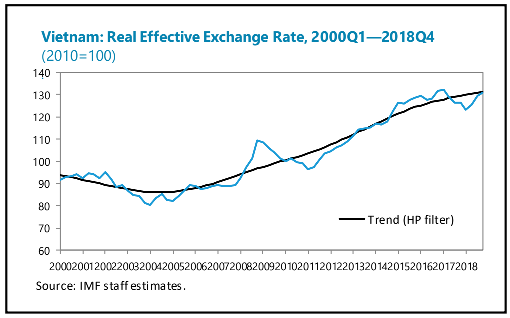
Vietnam: Savings, Investment and Current Account
(In percent of GDP)



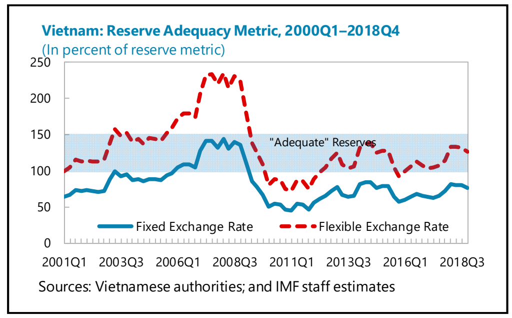
Sources: Vietnamese authorities; and IMF staff estimates.

[1] Prepared by David Corvino (APD).

3. **The real effective exchange rate (REER) appreciated in 2018.** The real effective exchange rate appreciated from the low levels of 2005 until 2016 by 4 percent on average every year. In 2017, the REER depreciated by 4.4 percent, as the Dong remained pegged to a weakening U.S. dollar. The trend reversed in 2018 and the REER appreciated by 3.5 percent through the year.



4. **The financial account balance is expected to decline in 2018.** FDI and FII inflows have been robust (US$15 and 3 billion) while private external disbursements continued to rise. In mid-2018, increased pressure on the Dong led to a temporary reversal of foreign equity flows and an increase in US dollar currency holdings by residents outside the formal financial sector.



5. **Reserve coverage stands at 76 percent of the adequacy metric.** In 2018, GIR increased by US$5.8 billion and reached US$55 billion.[2] Since 2016, FX reserves have doubled in US$ terms and the ratio to GDP increased by 4½ percentage point to 22.9 percent. Despite this large accumulation, the coverage remains at around 76 percent of the ARA metric, due to the rapid growth in Vietnam's exports, foreign liabilities and money supply. At around 2.4 months of imports of goods and services, reserves remain well under the regional emerging market countries' average of nine months.

6. **Vietnam's external position is assessed to be substantially stronger than warranted by fundamentals and desirable policies.** The current account approach of the external balance assessment (EBA) suggests a CA norm of -4.6 percent of GDP, indicating an undervaluation of 8.4 percent.[3] Policy gaps contributing to the CA gap relate to low public health expenditure and still high capital controls. This methodology could overstate the CA gap as EBA-lite does not account for the segmentation of the FDI sector from the rest of the economy, even though dualism is declining as links between the FDI sector and the rest of the economy grow. The equilibrium real exchange rate approach points to a substantial overvaluation, but the fit is poor, and staff's judgment relies on the adjusted REER results of the CA regression.

Vietnam: EBA-Lite Results, 2018

Approach	Current Account	REER
2018 Current Account	2.4%	
Current Account Norm	-4.6%	
Current Account Gap	6.4%	
o/w Policy Gap	-2.6%	
ln(REER) Actual		4.87
ln(REER) Norm		4.72
o/w Policy Gap		0.10
REER Gap	**-8.4%**	**15.2%**

Source: IMF staff estimates.

[2] While exchange rate flexibility has been increased *de jure*, the regime is *de facto* stabilized. The fixed exchange rate ARA metric is therefore appropriate.
[3] Vietnam is not included in the EBA sample. The analysis is based on the EBA lite tool.

7. In conclusion, there is evidence of substantial CA strength of some 6½ percent of GDP. This reflects the dualism still prevalent in Vietnam's economy. CA strength should be addressed through structural, institutional, and financial sector reforms to raise private investment and protect public investment while raising its efficiency. The modernization of the monetary framework, with greater two-way exchange rate flexibility, would also help external adjustment by facilitating nominal appreciation and reducing the need to accumulate reserves.

Appendix III. External and Public Sector Debt Sustainability Analyses[1]

Public and publicly guaranteed (PPG) debt has declined in recent years, from a peak of 60 percent of GDP in 2016 to 55.6 percent of GDP in 2018, the result of fiscal consolidation, rapid economic growth and low interest rates, and shifts in the composition of debt. Under staff's baseline, which incorporate less consolidation than the authorities' plan after 2019, PPG debt would continue to decline to less than 50 percent of GDP in 2024. Compared to the 2018 analysis, the debt trajectory is more benign, primarily due to the strict limits on new public guarantees, greater planned use of non-debt creating equitization revenues for budget financing and lower interest payments due to the phasing out of short-term financing. Staff assesses the debt sustainability risk as low. However, uncertainty about equitization revenues and risks from potential contingent liabilities related to banks and SOEs remain. Unfunded pension liabilities and infrastructure gaps must also be reckoned with over the longer term.

1. Background. The debt sustainability analysis (DSA) framework for market access countries is used to assess Vietnam's debt sustainability. The framework uses a risk-based approach and expands upon the basic DSA to include (i) an assessment of the realism of baseline assumptions and the projected fiscal adjustment; (ii) an analysis of risks associated with the debt profile; (iii) macro-fiscal risks; (iv) a stochastic debt projection considering past macro-fiscal volatility; and (v) a standardized summary of risks in a heat map. This DSA also examines the implications of implementation risks by considering a no-adjustment scenario.

2. Coverage. The DSA is performed on public domestic and external debt of the central and local governments and SOE debt guaranteed by the government and specialized financial institutions (SFIs). Debt guarantees are substantial in Vietnam, about 8 percent of GDP in 2018, and are projected to decline to around 5 percent in relation to GDP until 2024. Their inclusion is not common in DSAs of lower middle-income emerging market economies and is a conservative assumption made in light of potential financial difficulties of SOEs. Public debt held by Vietnam's social security system (VSS) of around 12 percent of GDP is included in the DSA as part of State debt.[2] A public DSA that focused on debt held outside the general government would markedly improve Vietnam's debt profile in the medium-to long-term. However, rapid aging is expected to deplete VSS assets quickly and to start adding to public debt starting in 2045 (see Appendix IV for a detailed analysis).

3. Macro-fiscal assumptions. Using the baseline, growth declines from 7.1 percent in 2018 to 6.5 percent in 2019 and over the medium term—the economy's potential. In the baseline, staff projects a primary fiscal deficit of 2.3 percent in 2019, declining to 1.2 percent of GDP in 2024.

4. Realism of baseline assumptions. The median forecast errors for real GDP growth, primary balance and inflation during 2009–17 are small, around -0.4 percent, showing no evidence of systematic projection bias that could undermine the assessment.

[1] Prepared by Anja Baum (FAD).

[2] Given the cross debts with VSS are not subtracted from public debt, and in line with the authorities' classification, the debt presented in the DSA is labelled "State debt", not General Government debt.

5. Public debt sustainability. Under the baseline, PPG debt is projected to decline to 54.4 percent of GDP in 2019, with privatization receipts and lower guarantees compensating for the primary deficit. Vietnam recently phased out short-term financing—the shortest bond maturities now are 5 years at issuance, with an average maturity of outstanding domestic debt of 8 years. This shift resulted in a substantial reduction in interest costs. PPG debt should reach 49.3 percent of GDP by 2024, comfortably below the government ceiling (65 percent of GDP) but in line with IMF suggested rule (limit PPG to below 55 percent of GDP, see IMF 2018).[3] The share of foreign currency-denominated debt is projected to decline from 44 percent in 2017 to 37 percent in 2024.

6. Constant primary balance. Under this scenario, with the deficit at its 2017 level, PPG debt would decline to about 52.5 percent of GDP. The historical scenario—in which real GDP growth, the primary balance and real interest rates are set at their historical average—leads to a slight increase of PPG debt to about 56 percent. Macro-fiscal stress tests suggest that Vietnam is currently under no risk of debt sustainability from core debt creating flows. Primary balance and real interest rate shocks lead to an upward revision in the debt projections of about 2 percent by 2024, compared to the baseline. A combined macro-fiscal shock in 2019 would increase PPG debt to 56 percent of GDP by 2024, which remains below Vietnam's 65 percent public debt ceiling.

7. Dynamic simulations. Probability distributions from a dynamic simulation of debt sustainability under an array of macroeconomic shocks show that in a negative-case scenario, PPG debt could reach 63 percent of GDP by 2024 with a 10 percent likelihood, while a combination of positive shocks would help reduce the debt-to-GDP ratio to 42 percent with a 25 percent probability.

8. Heat map. The heat map shows a low risk of debt distress and the gross financing needs-to-GDP ratio remains below the 15 percent threshold under all shocks. Possible risks in the public debt profile relate to debt held by non-residents, external financing requirements, and foreign currency debt. However, public debt held by non-residents, currently at 48 percent of total debt, is primarily in form of ODA lending, which overstates the actual risk of foreign held debt.

9. External debt sustainability. Vietnam's external debt-to-GDP ratio declined sharply to 45.6 percent in 2018. PPG external debt is on a downward trend—at 24 percent of GDP—in line with the authorities' switch to domestic financing sources and limiting of guarantees. Private external debt declined to 22.1 percent of GDP, owing to the reclassification of a large transaction from debt to FDI (a foreign investor bought US$ 4.7 billion worth of shares in an SOE equitized in December 2017).

10. Baseline. Under the baseline, external debt would increase moderately to 46.8 percent of GDP in 2019 and 52.7 percent of GDP by 2024, as gross external financing needs rise in line with the projected erosion of the current account surplus. Vietnam's external debt is vulnerable to real depreciation and current account shocks while growth and interest rate shocks have limited impact on external debt dynamics. The currency's observed long-term real appreciation trend is an upside.

[3] 2018. Vietnam. "Fiscal Rules in Vietnam: Calibration and Options," SM/17/157, IMF. The Staff Discussion Note uses stochastic simulations to identify a debt limit that takes into account fiscal and macroeconomic volatility.

Figure 1. Vietnam: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP unless otherwise indicated)

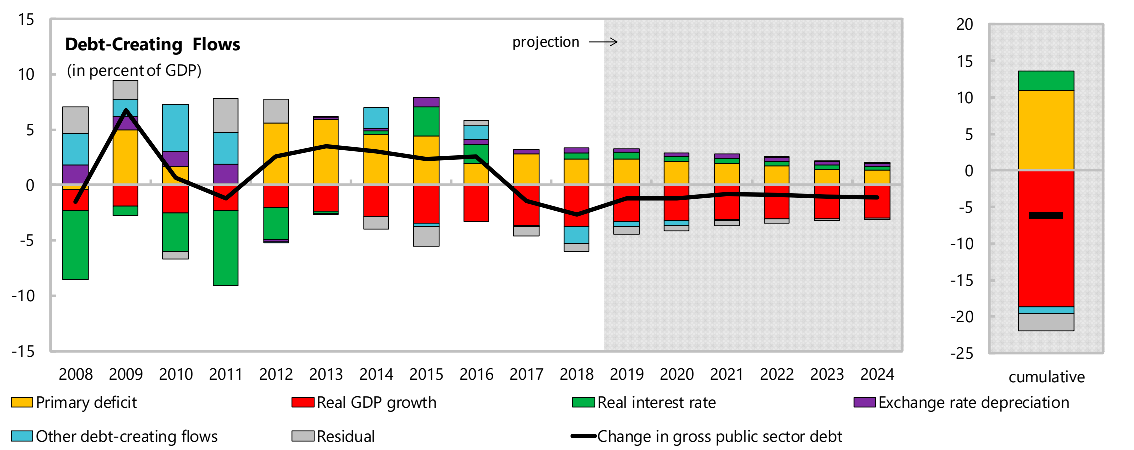
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross state debt	49.9	58.2	55.6	54.4	53.2	52.4	51.5	50.4	49.3
Of which: guarantees	10.2	9.1	8.0	7.2	6.7	6.2	5.8	5.5	5.3
Of which: state debt excl. guarantees	39.7	49.1	47.6	47.2	46.5	46.1	45.7	44.9	44.0
Of which: VSS borrowing	...	11.6	12.2	12.7	13.1	13.3	13.4	13.3	13.2
State gross financing needs	8.5	7.1	6.9	7.7	7.8	8.0	5.9	5.5	6.8
State debt (in percent of potential GDP)	49.8	57.9	55.4	54.4	53.3	52.4	51.5	50.5	49.4
Real GDP growth (in percent)	5.9	6.8	7.1	6.5	6.5	6.5	6.5	6.5	6.5
Inflation (GDP deflator, in percent)	9.2	4.1	3.3	3.2	3.3	3.3	3.5	3.7	4.0
Nominal GDP growth (in percent)	15.6	11.2	10.6	9.9	10.0	10.0	10.2	10.4	10.7
Effective interest rate (in percent) [4/]	4.2	4.3	4.5	4.6	4.5	4.5	4.6	4.7	4.9

As of April 23, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		140
5Y CDS (bp)		135
Ratings	Foreign	Local
Moody's	B1	B2
S&Ps	BB-	BB
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [10/]
Change in gross state sector debt	2.1	-1.4	-2.7	-1.2	-1.2	-0.8	-0.9	-1.1	-1.1	-6.3	-2.3
Identified debt-creating flows	1.4	-0.6	-2.0	-0.5	-0.7	-0.4	-0.6	-0.9	-0.9	-4.0	
Primary deficit	3.2	2.8	2.4	2.3	2.1	2.0	1.7	1.4	1.4	11.0	
Primary (noninterest) revenue and grants	24.6	24.5	24.5	23.4	23.3	23.2	23.2	23.2	23.1	139.4	
Primary (noninterest) expenditure	27.8	27.3	26.9	25.7	25.4	25.1	24.9	24.7	24.5	150.3	
Automatic debt dynamics [5/]	-3.4	-3.3	-2.7	-2.3	-2.4	-2.3	-2.3	-2.3	-2.3	-14.0	
Interest rate/growth differential [6/]	-4.3	-3.7	-3.2	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7	-16.1	
Of which: real interest rate	-1.8	0.0	0.5	0.6	0.5	0.5	0.4	0.4	0.3	2.6	
Of which: real GDP growth	-2.5	-3.7	-3.7	-3.3	-3.2	-3.1	-3.1	-3.0	-3.0	-18.7	
Exchange rate depreciation [7/]	0.9	0.4	0.5	...	...	...	...	...	...	...	
Other identified debt-creating flows	1.6	-0.1	-1.6	-0.5	-0.4	-0.1	0.0	0.0	0.0	-0.9	
Fiscal- Net privatization proceeds (negative)	-0.1	-1.2	-1.2	-0.8	-0.7	-0.3	-0.1	-0.1	-0.1	-2.1	
Contingent liabilities [8/]	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.1	
Fiscal- Net acquisition of financial assets	1.7	1.1	-0.4	0.3	0.2	0.2	0.2	0.1	0.1	1.1	
Residual, including asset changes [9/]	0.7	-0.9	-0.7	-0.7	-0.5	-0.4	-0.3	-0.2	-0.2	-2.3	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as SOEs.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes 0.2 percent of GDP remaining cost of recapitalizing Agribank (8.8 trillion dong), assumed to be finalized by end-2019.

9/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any).

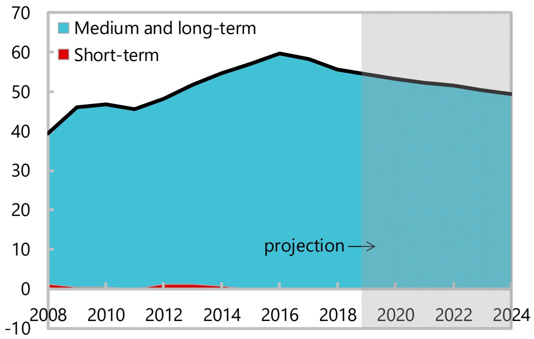
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Vietnam: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

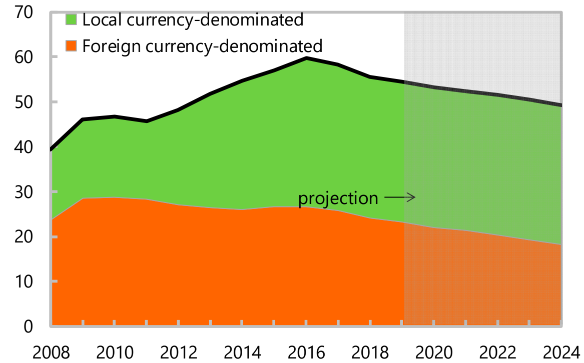
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

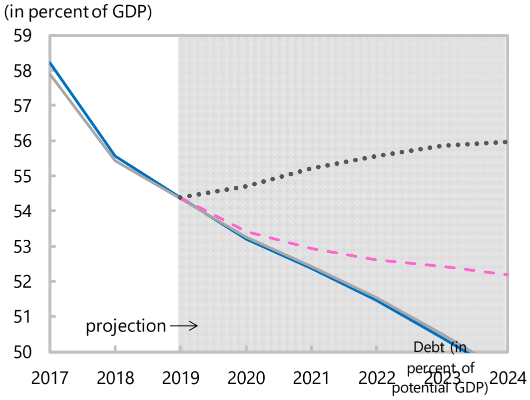


Alternative Scenarios

Baseline　Historical　Constant Primary Balance

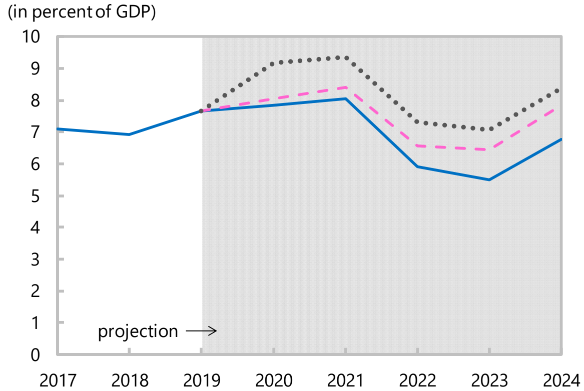
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

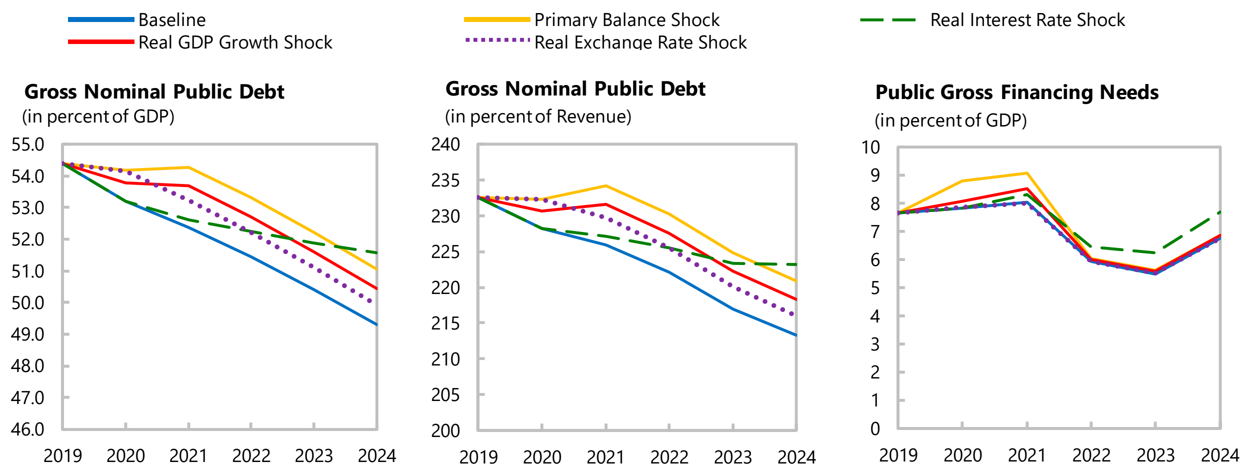
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	6.5	6.5	6.5	6.5	6.5	6.5
Inflation	3.2	3.3	3.3	3.5	3.7	4.0
Primary Balance	-2.3	-2.1	-2.0	-1.7	-1.4	-1.4
Effective interest rate	4.6	4.5	4.5	4.6	4.7	4.9
Constant Primary Balance Scenario						
Real GDP growth	6.5	6.5	6.5	6.5	6.5	6.5
Inflation	3.2	3.3	3.3	3.5	3.7	4.0
Primary Balance	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3
Effective interest rate	4.6	4.5	4.5	4.6	4.7	4.9

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	6.5	6.1	6.1	6.1	6.1	6.1
Inflation	3.2	3.3	3.3	3.5	3.7	4.0
Primary Balance	-2.3	-3.4	-3.4	-3.4	-3.4	-3.4
Effective interest rate	4.6	4.5	4.0	3.5	3.3	3.2

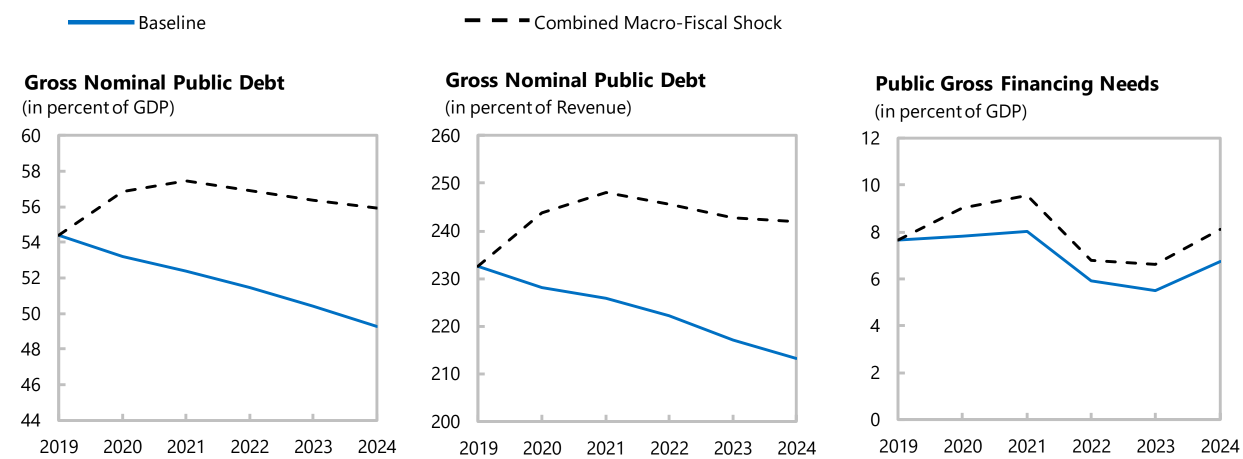
Source: IMF staff.

Figure 3. Vietnam: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	6.5	6.5	6.5	6.5	6.5	6.5
Inflation	3.2	3.3	3.3	3.5	3.7	4.0
Primary balance	-2.3	-3.1	-2.9	-1.7	-1.4	-1.4
Effective interest rate	4.6	4.5	4.6	4.7	4.8	5.0
Real Interest Rate Shock						
Real GDP growth	6.5	6.5	6.5	6.5	6.5	6.5
Inflation	3.2	3.3	3.3	3.5	3.7	4.0
Primary balance	-2.3	-2.1	-2.0	-1.7	-1.4	-1.4
Effective interest rate	4.6	4.5	5.2	5.9	6.4	7.0
Combined Shock						
Real GDP growth	6.5	5.9	5.9	6.5	6.5	6.5
Inflation	3.2	3.2	3.2	3.5	3.7	4.0
Primary balance	-2.3	-3.1	-2.9	-1.7	-1.4	-1.4
Effective interest rate	4.6	4.6	5.1	5.8	6.4	6.9

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	6.5	5.9	5.9	6.5	6.5	6.5
Inflation	3.2	3.2	3.2	3.5	3.7	4.0
Primary balance	-2.3	-2.3	-2.4	-1.7	-1.4	-1.4
Effective interest rate	4.6	4.5	4.5	4.6	4.8	4.9
Real Exchange Rate Shock						
Real GDP growth	6.5	6.5	6.5	6.5	6.5	6.5
Inflation	3.2	6.0	3.3	3.5	3.7	4.0
Primary balance	-2.3	-2.1	-2.0	-1.7	-1.4	-1.4
Effective interest rate	4.6	4.6	4.4	4.5	4.7	4.8

Source: IMF staff.

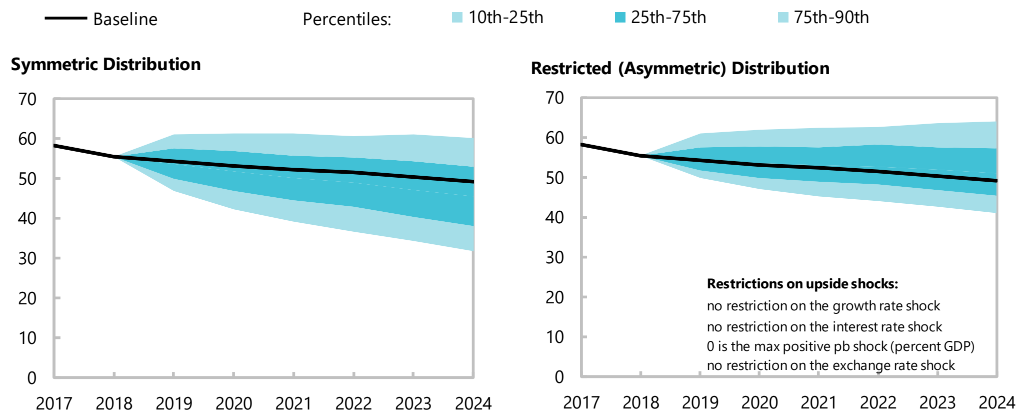
Figure 4. Vietnam: Public DSA—Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

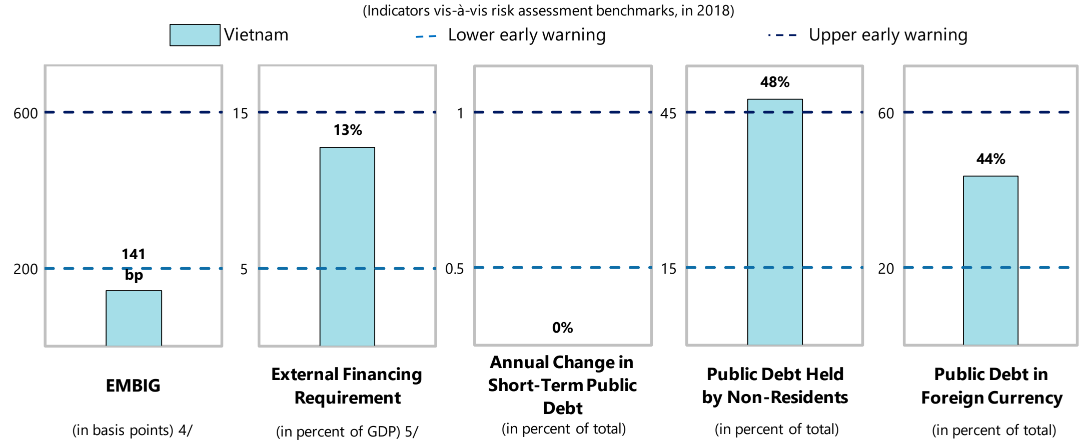
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

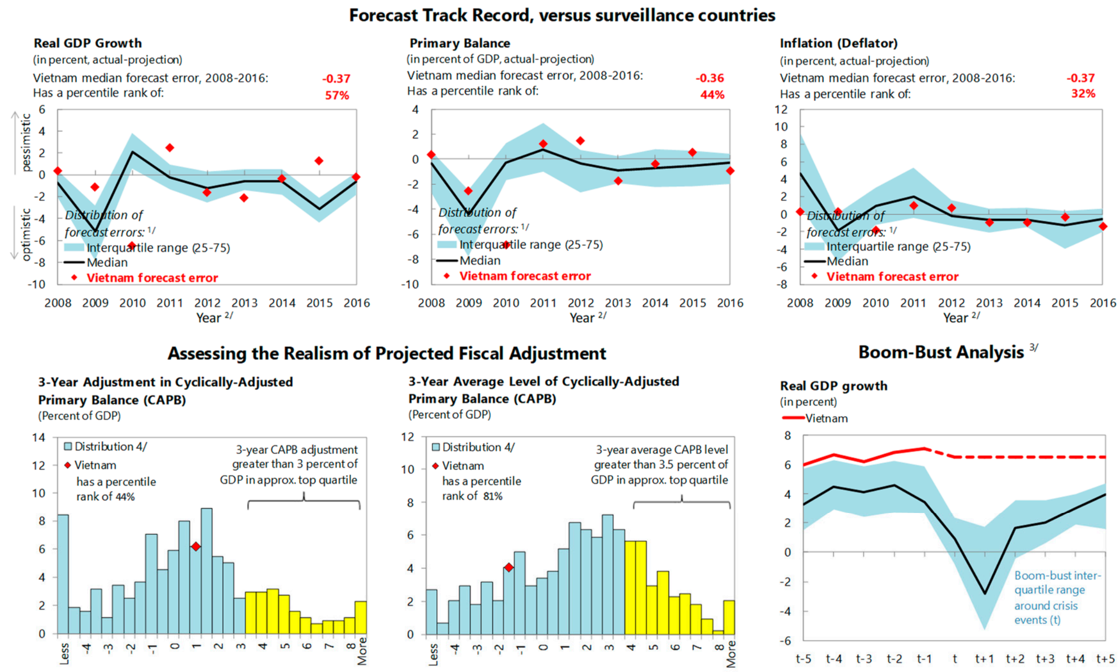
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 23-Jan-18 through 23-Apr-18.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

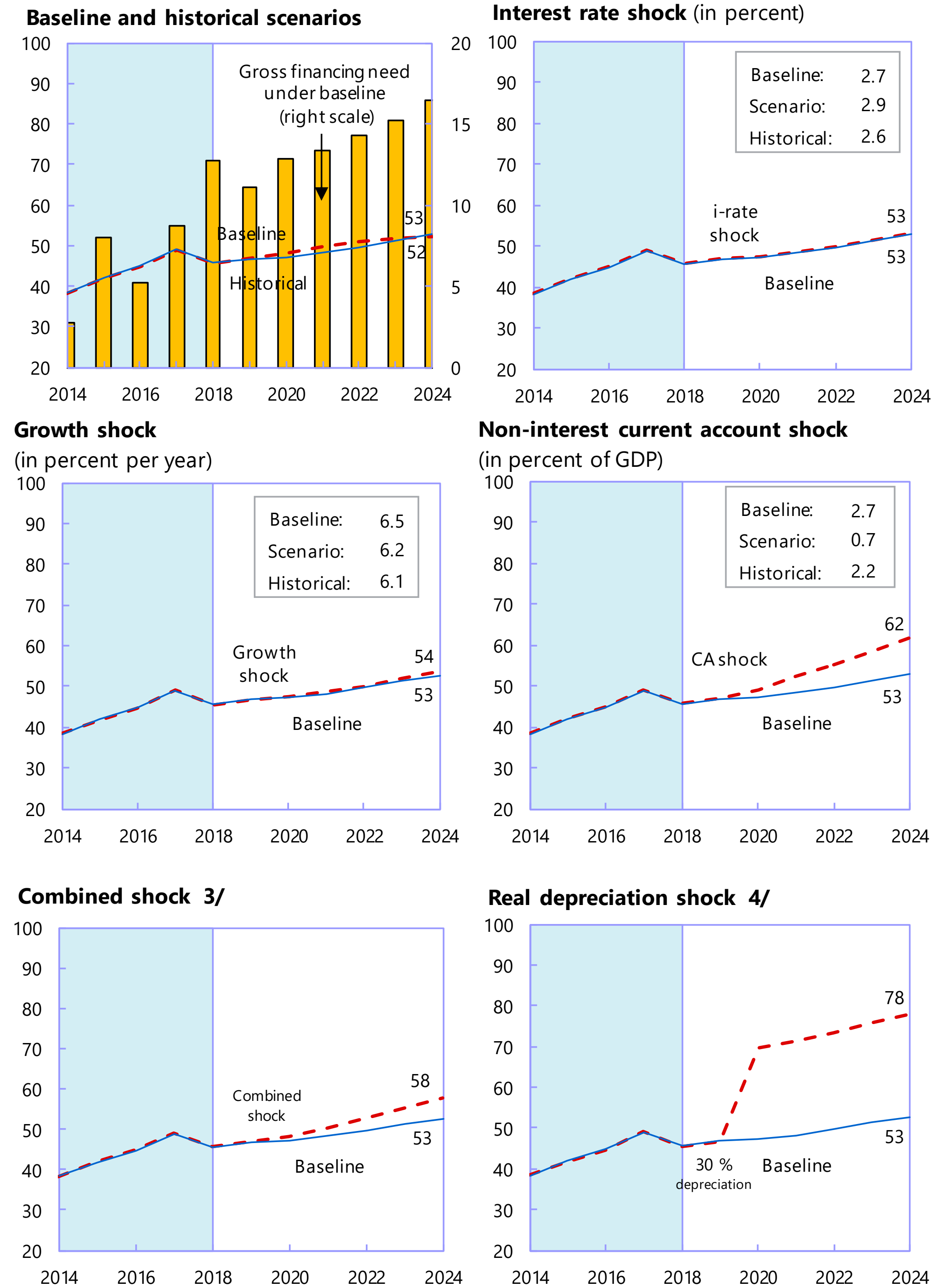
Figure 5. Vietnam: Public DSA—Realism of Baseline Assumptions



Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Vietnam has had a cumulative increase in private sector credit of 21 percent of GDP, 2015-2018. For Vietnam, t corresponds to 2019; for the distribution, t corresponds to the first year of the crisis.
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 6. Vietnam: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2015.

Table 1. Vietnam: External Debt Sustainability Framework, 2014–2024

(In percent of GDP, unless otherwise indicated)

	Actual							Projections							
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024		Debt-stabilizing non-interest current account 6/
Baseline: External debt	38.3	41.9	44.8	49.0	45.6			46.8	47.2	48.3	49.6	51.2	52.7		-8.3
Change in external debt	1.0	3.6	2.9	4.2	-3.4			1.2	0.4	1.1	1.3	1.6	1.5	0.0	
Identified external debt-creating flows (4+8+9)	-12.3	-6.6	-10.8	-12.2	-12.9			-11.2	-10.9	-10.6	-10.1	-9.8	-9.5	0.0	
Current account deficit, excluding interest payments	-5.6	-0.8	-3.7	-3.1	-3.7			-3.3	-3.0	-2.9	-2.6	-2.4	-2.3	8.3	
Deficit in balance of goods and services	-4.6	-1.1	-3.2	-3.1	-4.8			-4.6	-4.5	-4.5	-4.4	-4.4	-4.3		
Exports	86.8	90.6	93.8	103.6	107.2			111.0	115.2	120.2	125.4	130.8	136.6		
Imports	82.1	89.5	90.5	100.4	102.4			106.4	110.7	115.7	121.0	126.4	132.2		
Net non-debt creating capital inflows (negative)	-4.3	-5.6	-5.8	-6.2	-6.2			-6.2	-6.1	-6.0	-5.8	-5.6	-5.4	-5.4	
Automatic debt dynamics 1/	-2.4	-0.2	-1.3	-2.9	-2.9			-1.7	-1.7	-1.7	-1.7	-1.7	-1.8	-2.9	
Contribution from nominal interest rate	0.7	0.9	0.8	1.0	1.3			1.1	1.1	1.2	1.2	1.2	1.3	1.3	
Contribution from real GDP growth	-2.0	-2.5	-2.5	-2.8	-3.2			-2.7	-2.8	-2.8	-2.9	-3.0	-3.1	-3.2	
Contribution from price and exchange rate changes 2/	-1.0	1.4	0.4	-1.1	-1.1			...	...	...	...	...	...	-1.1	
Residual, incl. change in gross foreign assets (2-3) 3/	13.3	10.2	13.7	16.3	9.5			12.4	11.2	11.6	11.5	11.4	11.0	0.0	
External debt-to-exports ratio (in percent)	44.2	46.2	47.8	47.3	42.5			42.2	40.9	40.1	39.6	39.1	38.6		
Gross external financing need (in billions of US dollars) 4/	5.0	15.2	10.5	19.3	30.8			29.0	36.3	40.7	47.3	54.7	64.2		
in percent of GDP	2.7	7.9	5.2	8.7	12.8	10-Year	10-Year	11.1	12.9	13.3	14.3	15.2	16.4		
Scenario with key variables at their historical averages 5/								46.8	48.1	49.6	50.8	51.7	52.3		-8.8
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							For debt stabilization	
Nominal GDP (US dollars)	185.8	191.3	201.3	220.4	241.3			260.5	282.4	305.8	331.3	359.6	391.0	425.2	
Real GDP growth (in percent)	6.0	6.7	6.2	6.8	7.1	6.1	0.6	6.5	6.5	6.5	6.5	6.5	6.5	6.5	
Exchange rate appreciation (US dollar value of local currency, change in percent)	-0.8	-3.3	-2.0	-1.5	-1.0	-3.2	2.9	-1.8	-1.5	-1.6	-1.7	-1.7	-1.8	-1.8	
GDP deflator (change in domestic currency)	3.7	-0.2	1.1	4.1	3.3	6.7	6.4	3.2	3.3	3.3	3.5	3.7	4.0	4.0	
GDP deflator in US dollars (change in percent)	2.8	-3.5	-0.9	2.5	2.2	3.2	4.9	1.4	1.8	1.7	1.8	1.9	2.1	2.1	
Nominal external interest rate (in percent)	2.1	2.3	2.0	2.4	2.9	2.6	0.5	2.5	2.6	2.7	2.7	2.7	2.7	2.7	
Growth of exports G&S (US dollar terms, in percent)	12.9	7.5	9.0	20.9	13.3	14.6	11.6	11.9	12.5	13.0	13.0	13.2	13.5		
Growth of imports G&S (US dollar terms, in percent)	11.3	12.2	6.5	21.4	11.6	12.0	10.6	12.3	12.8	13.1	13.3	13.4	13.7		
Current account balance, excluding interest payments	5.6	0.8	3.7	3.1	3.7	2.2	3.9	3.3	3.0	2.9	2.6	2.4	2.3		
Net non-debt creating capital inflows	4.3	5.6	5.8	6.2	6.2	5.5	0.9	6.2	6.1	6.0	5.8	5.6	5.4		

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

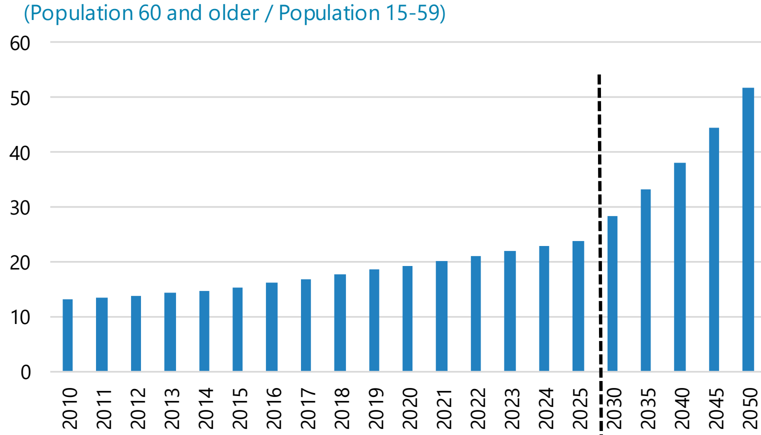
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix IV. Vietnam's Pensions and VSS: Impact on the Public Debt[1]

1. **Rapid prospective aging.** Vietnam's population will be aging rapidly in coming decades, making deeper reforms in the pension system now a priority. The old dependency ratio expected to double of the next 25 years (Figure 1), and replacement rates are around 70 percent, significantly above the OECD average of 54 percent. At the same time, retirement ages are low, with 55 years for women and 60 years for men, far below the OECD average of 67 years, but also below that of other Asian countries (between 63 and 65 years of average). Coverage is still low (estimated at about 20-25 percent), and will unlikely increase fast given a large informal sector in Vietnam.

2. **Vietnam's Social Security (VSS).** VSS will play an increasing role in Vietnam's debt dynamics as of 2030. Within the next decade, a rapidly aging population will push VSS expenditure upwards at an accelerated pace. The below baseline projections show that, in absence of policy changes, developments at VSS could lead to an explosive public-sector debt dynamic as of 2045.

Figure 1. Old Age Dependency Ratio
(Population 60 and older / Population 15-59)



Source: IMF Staff estimates; WB.

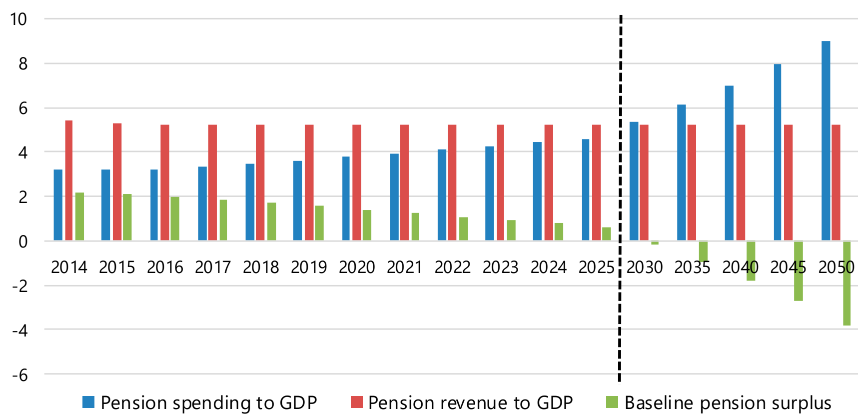
3. **Baseline pension projection.** Projections indicate that the Pension Fund, the largest element of Vietnam's Social Security (VSS), will run deficits starting around 2035 (Figure 2). Pension revenue stood at around 5.2 percent of GDP, and expenditure at 3.2 percent of GDP in 2017. Keeping all parameters constant, spending will increase steadily, and overtake revenues in 2030. The NPV of pension liabilities until 2050 (1 percent discount rate) are 172 percent of GDP, while the NPV of pension revenues lies at 158 percent of GDP.

4. **In the absence of reforms VSS deficits will raise PPG debt.** VSS is financially unsustainable in the absence of reforms. Without policy changes, the deficit in the pension

[1] Prepared by Anja Baum (FAD).

system could add to public debt as of 2035. VSS holds and invests about 90 percent of all assets and surpluses in government bonds, roughly 12 percent of GDP. PPG debt net of VSS holdings of government debt is 46 percent of GDP in 2017. Yet, projected VSS deficits will require additional borrowing in the future in the absence of reforms. Even with the health insurance fund kept in financial balance, by 2022 GDP growth is expected to outpace VSS asset growth. Around 2035, when VSS will start experiencing deficits and its assets will decline to around 7 percent of GDP by 2035 (Figure 4). VSS is expected to run out of assets in 2044 and will have to borrow in addition to the general government. By 2050, VSS debt could be as high as 8 percent of GDP.

Figure 2. Vietnam Pension Surplus 2014–2050



Source: IMF Staff estimates.

5. Begin VSS reforms now. While pension reforms are difficult, they take decades to complete and should be implemented as soon as possible to ensure long-term sustainability. An aging population will equally put strain on Vietnam's health insurance fund, which has few assets to spare and has already been experiencing almost zero balances over the last years.

6. Menu of parametric reforms. Several possible parametric reforms to delay and reduce the overall deficit in Vietnam's pension system are examined. All policy changes are implemented as of 2021, with the following scenarios considered:

- <u>Inflation indexation:</u> This scenario assumes a full shift from wage indexation to inflation indexation, with real wage growth assumed at [5.5] percent, and inflation at 3.5 percent per year.

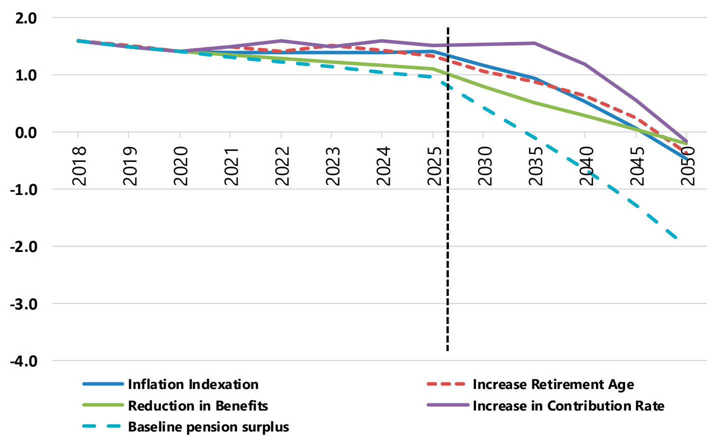
- <u>Increase in retirement age:</u> The scenario assumes an increase in the official retirement age of 0.4 years per year, until the retirement age of 62 for women, and 65 for men. An increase of retirement ages in an 0.4 increment until 62 years of age for both men and women is already being discussed by the authorities.

- <u>Reduction in benefits:</u> The scenario assumes a 1 percent reduction per year compared to the baseline, until a total reduction of 1/3 compared to the baseline is reached (in 2050).

- Increase in the contribution rate: The scenario assumes an increase of 1 percent of contributions compared to the baseline every two years until a 10 percent total increase is reached in 2035.

- Increase in coverage: This scenario assumes that the pension coverage increases with nominal per capita GDP until it reaches 80 percent of the workforce (in 2035). Given a significant lag in covered pensioner numbers, their number increases by 1 percent of additional contributors per year compared to the baseline until 2030. After, each year an additional 2 percent are added, until covered pensioner numbers reach 80 percent of total pensioners (in 2055).

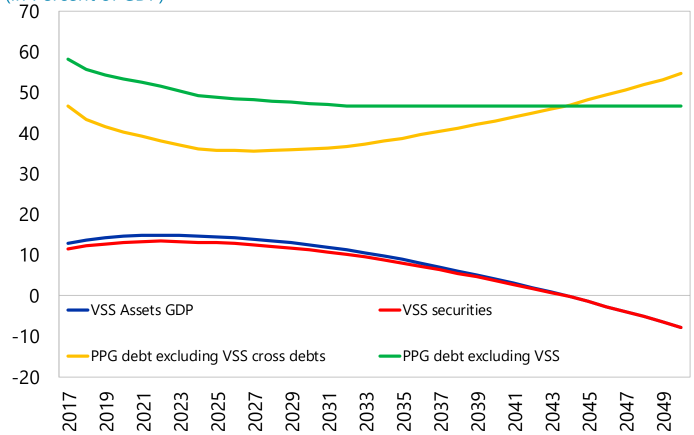
Figure 3. Vietnam Pension Surplus - Scenario Analysis



Source: IMF Staff Estimates.

7. All policy changes significantly delay the deficit in the pension fund. Inflation indexation, a reduction in benefits, and an increase in retirement ages would push the first deficit occurrence to around 2045. Increases in the contribution rate would delay the first deficit occurrence to 2050. An increase in coverage rates would push the pension surplus up noticeably until 2045. However, absent other reforms the fast increase in covered pensioners as of 2035 would lead to rapid spending increase and a significantly larger structural pension deficit as of 2050. Out of all scenarios, the reduction in benefits would lead to the lowest long-term deficit. While some of these measures individually might seem drastic, a combination of several of them would put the pension fund at a more sustainable footing.

Figure 4. Vietnam: PPG Debt and VSS
(In Percent of GDP)



Source: IMF Staff estimates.

Appendix V. Monetary Policy and the Exchange Rate[1]

This Appendix is concerned with the factors determining Vietnam's real exchange rate trends and the implications of introducing a new monetary policy framework. The Balassa-Samuelson relationship and two policy rules, for reserve accumulation and interest rate reactions, are embedded in a small open economy DSGE model. The main findings are: (i) Real exchange rate developments are explained mostly by Balassa-Samuelson effects, (ii) a rules-based FX intervention strategy has effectively stabilized the nominal FX rates and inflation, and (iii) an inflation target regime can be a more effective nominal anchor than FX intervention.

1. **The foreign exchange (FX) rate is one of nominal anchors for monetary policy in Vietnam.** The State Bank of Vietnam (SBV) sets 4 percent of inflation as a domestic nominal anchor, but in addition to the target inflation rate, the SBV daily announces the target FX rate vis-à-vis US dollar as an external nominal anchor. To keep the FX rates within the predetermined band around the target, the SVB actively intervenes to the FX market through their reserve accumulation/decumulation, in addition to adjusting interest rates in the interbank market.

2. **Introducing more FX flexibility is a key to modernizing a monetary policy framework**. While a political decision requires broader consensus building to overcome pervasive fear of floating in the government, there is consensus in the SBV for a shift to inflation targeting (IT). Given the "trilemma" in international economics, introducing more FX flexibility is a key step for modernizing their monetary policy framework toward the IT regime. Hence, investigating what drives FX rates and how FX flexibility affects the macroeconomy should help them move ahead toward IT.

3. **To examine the effects of introducing FX flexibility, the following two-step approach is adopted, based on DSGE modeling**.

(i) First, a small open economy DSGE model is constructed and its parameters estimated on Vietnamese data. Then, the time series data for output growth, inflation and real exchange rates are decomposed into several structural shocks.

(ii) Second, keeping the estimated structural parameters and shocks unchanged, *counterfactual* policy exercises for the economy are conducted: (i) without FX interventions, and (ii) with strict commitment to IT.

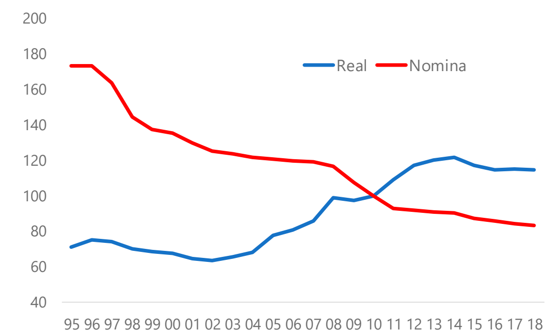
It is important to use a micro-founded model for the counterfactual policy exercises because any changes in a policy framework will change the private sector's behavior (Lucas critique). For instance, investors' behavior in a floating FX system is expected to be different from that in a fixed FX system, where the SBV systematically reacts to FX fluctuations. Hence, the estimated relationship between aggregate variables under a fixed exchange rate regime by, for instance, VAR cannot be directly used to analyze the effects of introducing a new policy framework.

[1] Prepared by Mitsuru Katagiri (MCM).

A. Real Exchange Rate Trends and FX Intervention in Vietnam: Background

4. **Over the last two decades, Vietnam has experienced a secular trend of appreciation in the real FX rate and depreciation in the nominal FX rate.** The real FX rate vis-à-vis the US dollar is on a secular trend of appreciation and has been appreciated by more than 60 percent in the last two decades. On the other hand, the nominal FX rate vis-à-vis the US dollar has been continuously depreciated for the last two decades. By definition, the difference between the real and nominal FX rate is accounted for by high and volatile inflation, whose average was around eight percent for the last two decades.

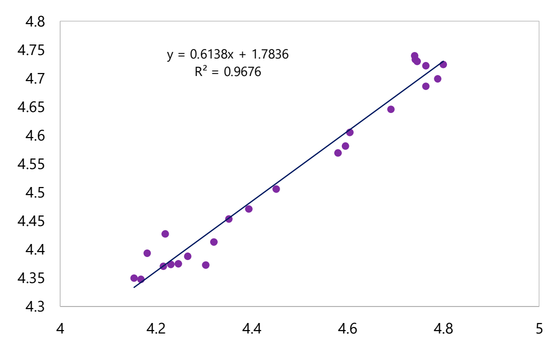
Vietnam: Nominal and real exchange rate (2010=100)



Source: IMF Staff estimates.

5. **The real FX rate has been mostly tracked by the relative price of manufacturing sector.** Given the law of one price for tradable goods, the theory predicts that the real FX rate is approximated by a tradable goods price relative to a price index of consumption basket. Following the literature, the relative price of manufacturing sector (=the deflator for manufacturing sector divided by GDP deflator), is used as a proxy for the relative price of tradable goods. As in the theoretical prediction, the real FX rate vis-à-vis the US dollar can be tracked by the relative price of manufacturing sector in Vietnam (R-squared is more than 0.96 for the last two decades), probably reflecting the fact that the manufacturing sector in Vietnam is an export-oriented sector with many FDI firms.

Vietnam: Relative Price of Manufacturing and Real ER



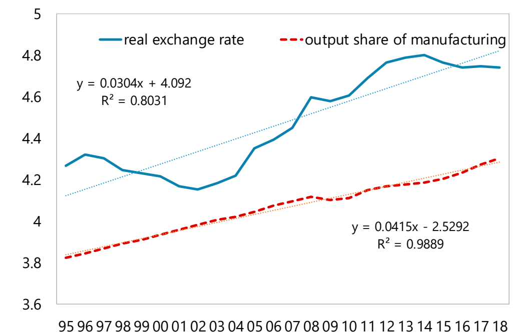
Sources: Haver; and IMF staff calculations.

6. **The secular trend of appreciation in the real FX rate is consistent with the Balassa-Samuelson relationship.** The Balassa-Samuelson effect predicts the cointegration relationship between the real FX rate and the relative productivity growth for the tradable goods sector. Since the share of output is cointegrated with relative productivity growth on a balanced growth path, the theoretical prediction of the Balassa-Samuelson relationship is reformulated by the following cointegration relationship,

$$\log(\text{Real FX rate}_t) = (1-\iota) \times \log\left(\frac{Y_{\text{tradable},t}}{Y_{\text{Non tradable},t}}\right)$$

where ι is the share of tradable goods in output.[2] Given that the relative price of the manufacturing sector has tracked the real FX rate, the output share of the manufacturing sector is used as a proxy for the output share of tradable goods. As shown in Text figure, both the real FX rate and the output share of the manufacturing sector are on a secular upward trend, thus they are obviously cointegrated. This cointegrated relationship is utilized for defining a balanced growth path and detrending in a DSGE model for estimation.

Vietnam: Balassa-Samuelson effects



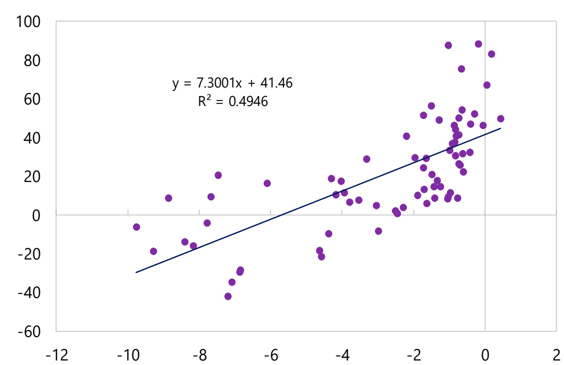
Sources: Haver; and IMF staff calculations.

7. The SBV actively responds to FX depreciation by intervening to the FX market through reserve decumulation. In the scatter plot between the nominal FX rate vis-à-vis the US dollar and changes in the FX reserve, there is a clear negative relationship. To estimate the SBV's policy rule for reserve accumulation (and decumulation), I estimate the following equation under the assumption of (a sort of) cointegration between nominal GDP and the FX reserve:

$$\Delta \text{Reserve}_t = \beta_0 + \beta_1 \Delta \text{Nominal FX}_t + \beta_2 \text{Reserve\_to\_NGDP}_{t-2} + \varepsilon_t$$

In this policy rule, the delta means the quarter-on-quarter percent change, and the second term is supposed to capture the convergence to the long-term equilibrium level. The estimation may face a negative bias due to an endogeneity problem because the FX intervention by the SBV should influence the FX rate simultaneously. Hence, the lagged nominal FX rate is used as an instrumental variable to avoid the endogeneity problem in the two-stage least squares estimation. The estimation result using the data from 2004Q4-2018Q3 shows that all parameters are statistically significant and indicates that the quarterly-on-quarterly growth in FX reserve will: (i) decline by 8.6 percent in response to FX depreciation by one percentage point, and (ii) decline by 0.1 percent in response to a one percentage point increase in the reserve to GDP ratio. The second result implies that the SBV hesitates to intervene to the FX market when they do not have sufficient FX reserve (and vice versa).

Vietnam: Reserve decumulation and FX depreciation



Sources: State Bank of Vietnam; and IMF staff calculations.

[2] See Khan (2004) for derivation of the Balassa-Samuelson relationship in a structural model.

8. The effect of FX intervention is hard to be identified due to the endogeneity problem. To deal with this endogeneity problem, the literature uses instrumental variables including the reserve-to-GDP ratios to estimate the effect of FX intervention. For instance, Adler et al. (2015) uses several instrumental variables and conclude "a purchase of foreign currency of 1 percentage point of GDP causes a depreciation of the nominal exchange rates in the rage of [1.7, 2.0]." Such estimation strategy, however, does not work for the case in Vietnam due to the small number of samples. Hence, the effect of FX intervention is estimated by a structural estimation using a DSGE modeling.

B. Small Open Economy DSGE Model for Vietnam

9. The model is based on a standard small open economy DSGE model. As in a standard model, the model consists of: (1) the IS curve (i.e., Euler equation), (2) the new Keynesian Phillips curves for tradable and non-tradable goods, (3) the monetary policy following the Taylor rule, (4) the uncovered interest parity (UIP) condition, and (5) the market clearing conditions including the balance of payment identity. Since the consumption basket consists of tradable and non-tradable goods, the real FX rate is cointegrated with the output share of tradable goods via the Balassa-Samuelson relationship on the balanced growth path.

10. In addition to the standard equations, the reserve accumulation rule is incorporated for modeling FX interventions and their effects through the liquidity effect. Specifically, the reserve accumulation/decumulation rule for the SBV is formulated as the one responding to changes in the nominal FX rate vis-à-vis the US dollar and the lagged reserve to GDP ratios, in line with the estimation in Section A. To make the FX intervention effective in the model, the model assumes the adjustment cost for the foreign asset which generates a pecuniary cost for changing the foreign asset position of private agents. With the adjustment cost, the UIP condition is augmented by changes in the foreign asset positions such that,

$$\mathrm{r}_{\mathrm{t,VNM}} + \Delta \mathrm{Real\ FX}_{\mathrm{t+1}} = \mathrm{r}_{\mathrm{t,USA}} - \phi(\mathrm{b}_{\mathrm{t}} - \mathrm{b}_{\mathrm{t-1}})$$

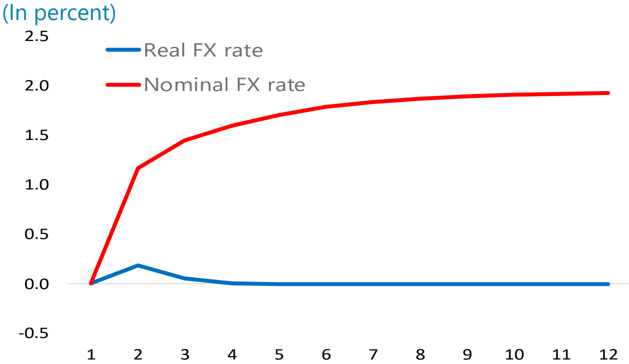
where b_{t} is the amount of foreign assets held by private sectors. Due to the adjustment cost, the central bank can appreciate (depreciate) the FX rate via liquidity effects by supplying (withdrawing) the US dollar in the FX market. Also, the interest rate is assumed to be potentially influenced by reserve accumulation through non-sterilized interventions.

C. Estimation and Variance Decomposition

11. The model parameters and structural shocks are estimated by a Bayesian method using quarterly data for Vietnam. The model estimation uses the quarterly data from 2005Q1 to 2018Q3 for the following seven variables: (1) GDP growth, (2) GDP growth for the manufacturing sector, (3) the CPI inflation rate, (4) the nominal interest rate (the discount rate), (5) the reserve to GDP ratio, (6) the FX rate vis-à-vis the US dollar, and (7) the real interest rate in the U.S. (FF rate deflated by CPI inflation). The prior distributions for the parameters of the FX intervention rule are based on the estimated values in Section A, and those for other parameters are based on the conventional values.

12. The estimation result implies that FX interventions affect the FX rate via the liquidity effect (sterilized) and the nominal interest rate (non-sterilized) in Vietnam. While the prior distribution for the parameter of the adjustment cost, ϕ, is assumed to be centered around zero, the posterior distribution clearly indicates the positive adjustment cost for foreign asset positions, suggesting that there exists the effect of FX interventions via the liquidity effect in Vietnam. Furthermore, the estimated interest rate rule for the SBV implies that part of FX interventions has not been sterilized. The impulse response to FX intervention shock (Text figure) shows that FX interventions by 1 percentage point of GDP induces 1.2-1.9 percentage point appreciation of the nominal FX rate, which is in line with the empirical estimation by cross-country panel data (Adler et al. 2015). However, the effects of FX interventions on the real FX rate are small and short-lived probably due to the high pass-through of FX rates in Vietnam. Hence, while a theory suggests that the central bank may be able to use FX interventions as a policy tool to mitigate the real FX rate gap from the fundamental value (e.g., Ghosh 2016), it may be difficult to do it in Vietnam.

Vietnam: Impulse Response to FX interventions
(In percent)



Source: IMF Staff estimates.

13. The variance decomposition shows that: (i) the real FX rate has been mostly driven by the internal shock via the Balassa-Samuelson effect, and (ii) the nominal FX rate, inflation and the FX reserve have been somewhat driven by the monetary policy shock. By using a Kalman smoothing, time series data for the real and nominal FX rate, inflation and FX reserve are decomposed into a few structural shocks, namely, (1) Internal shocks (the TFP shock for aggregate and manufacturing sector), (2) External shocks (the FX rate shock and the U.S. monetary policy shock), (3) the FX intervention shock, and (4) the monetary policy shock. The result of variance decomposition (Text table) is summarized as follows.

- **Real FX rate:** More than half of fluctuations can be explained by the internal shocks, including TFP shock to manufacturing sector, via the Balassa-Samuelson effect. The other half of variance is mostly explained by the shock to the real FX rate, which is measured as deviations from UIP. Other factors including the FX intervention and monetary policy shock are almost negligible to explain the real FX rate in Vietnam.

- **Nominal FX rate:** While the internal shock is still a main driver, its contribution is much smaller than that for the real FX rate. Instead, the FX intervention and monetary policy shock significantly influence its fluctuations (20 and 15 percent, respectively).

- **Inflation:** While more than half of fluctuations is driven by the internal shock, the FX intervention and monetary policy shock play a significant role as in the nominal FX rate, suggesting that the SBV's policy shocks have influenced internal and external nominal variables simultaneously. The contribution of the external shock to inflation is small and less than 10 percent.

- **FX reserve:** The contribution of the FX intervention shock is very small, implying that FX reserve in Vietnam mostly is driven by a systematic part rather than a non-systematic part of FX interventions. Among the systematic responses of FX reserve, the monetary policy shock is the main driver of FX reserve and accounts for more than half of its fluctuations. Hence, the FX intervention in Vietnam is interpreted as a response to nominal FX rate fluctuations caused by the domestic monetary shock.

Vietnam: Variance Decomposition for Real and Nominal FX Rate and Inflation

(%)

	Internal shock	External shock	FX intervention	Monetary policy
Real FX rate	63.4	35.6	0.7	0.3
Nominal FX rate	36.5	26.5	21.5	15.6
Inflation rate	53.9	7.8	21.9	16.4
FX reserve	13.6	23.8	5.1	57.5

Note: "Internal shock" includes the aggregate and manufacturing TFP shocks, and "External shock" includes the FX rate shock (deviatinos from UIP) and the US monetary policy shock.
Source: IMF Staff estimates.

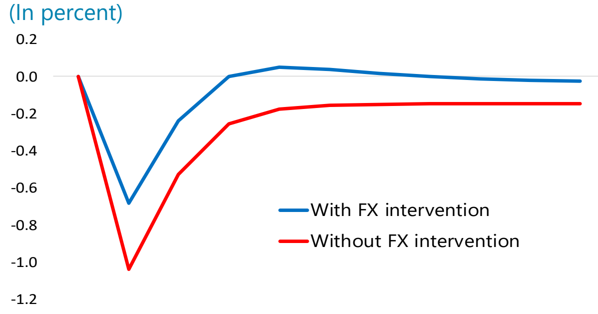
D. Counterfactual Policy Exercise for FX Flexibility

14. The effects of introducing FX flexibility are examined by a counterfactual policy exercise. A counterfactual monetary policy framework under the floating FX regime is modeled by muting the response of reserve accumulation to the nominal FX rate and setting the FX intervention shock to zero for all periods. In addition, another counterfactual simulation examines whether a stricter inflation target regime can be a substitute for FX interventions. To answer this question, the simulation exercise models a counterfactual policy framework with a stricter IT regime by muting the response of nominal interest rate to the nominal FX rate and FX reserve but reinforcing its response to inflation. The counterfactual simulation paths for inflation, the nominal FX rate and output growth are produced by changing the structural parameters to the counterfactual policy parameters and inserting the estimated sequence of structural shocks into the model.

15. The impulse response function implies that FX interventions would mitigate the depreciation pressure stemming from the US monetary policy tightening. In the baseline model with FX interventions, a 1 percentage point increase in the US interest rate would

Vietnam: Impuse Response to the US Interest Rate

(In percent)



Source: IMF Staff Estimates.

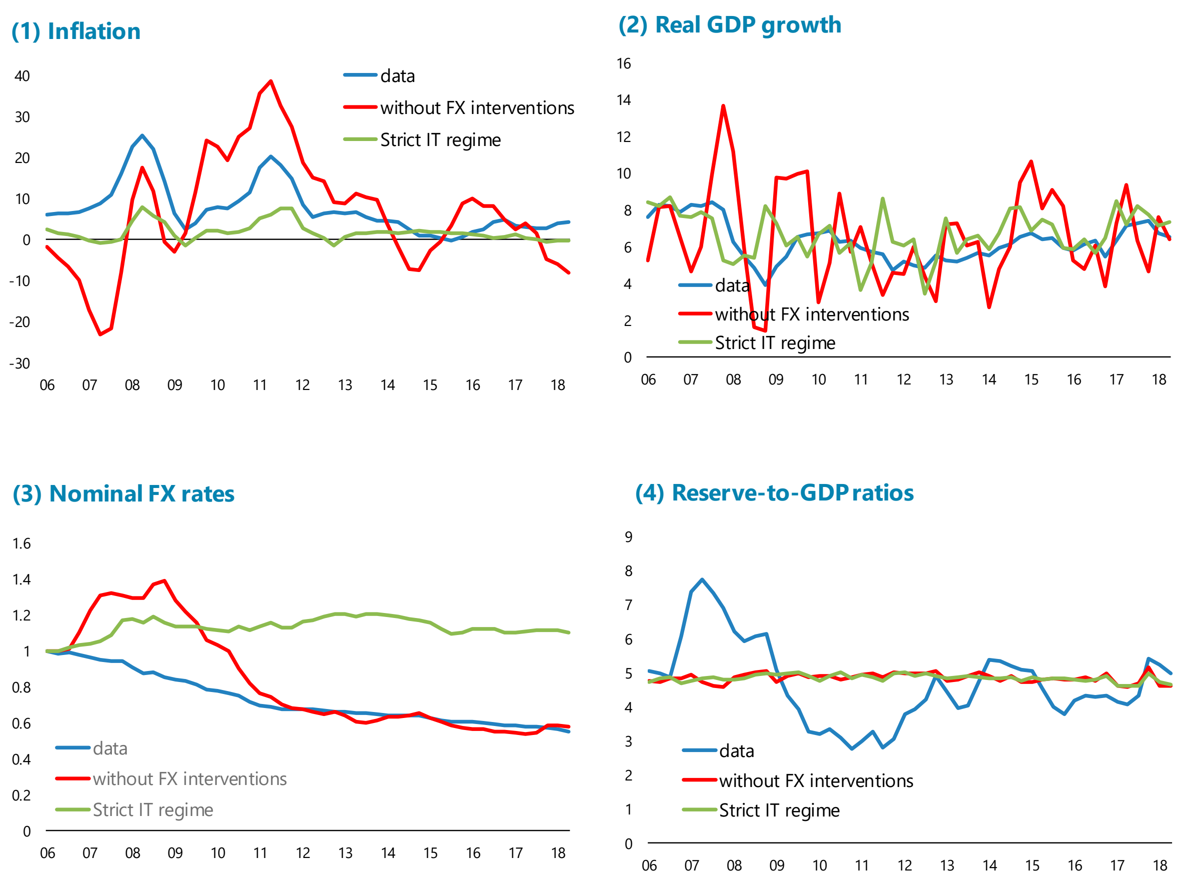
depreciate the nominal FX rate vis-à-vis the US dollar by around 0.6 percent on impact but almost neutral in the long run. However, in the counterfactual economy without FX interventions, the same size of US monetary policy tightening would cause more than 1 percent depreciation of the nominal FX rate and the effects on nominal FX rate would remain even in the long run, implying that the rule-based FX intervention can mitigate the depreciation pressure caused by an external shock.

16. **Without FX interventions, Vietnam would have experienced significantly larger volatility (the red lines in Text figure).** In the counterfactual case without FX interventions, the nominal FX rate would have experienced much more depreciations in the last decade, particularly around the global financial crisis. Reflecting the larger depreciation in the nominal FX rate, the average inflation rate would have been much higher (around 22 percent relative to 8 percent in data). Furthermore, without FX interventions, the standard deviation of the nominal FX rate, inflation and output growth would have been more than doubled, suggesting that FX interventions have significantly dampened the economic volatility.

17. **The stabilization effects of FX interventions are mostly exerted by the systematic response to the nominal FX rate.** While it is not shown in the figures, muting the FX intervention shock (non-systematic part of FX interventions) has little effects on the counterfactual simulation paths, suggesting that the systematic part of reserve accumulation/decumulation responding to the nominal FX rate is more important for stabilizing the economy. Intuitively, the systematic FX intervention has larger policy effects because it would change investors' expectations about future developments in nominal FX rates. This result is in line with the previous literature emphasizing the efficacy of rule-based FX interventions (e.g., Basu et al. 2018).

18. **A stricter inflation target regime can be a substitute for the FX intervention to stabilize the economy (the green lines in Text figure).** The counterfactual simulation paths under a stricter IT regime is produced by: (i) muting the response of nominal interest rate to nominal FX rates and FX reserve, but (ii) doubling its response to inflation and setting the monetary policy shock to zero for all periods. Under this counterfactual policy framework, both the level and volatility of inflation would have been much lower than data, and consequently the nominal FX rate would have not been depreciated but almost flat. As a byproduct of lower inflation volatility, however, real GDP growth would have been somewhat more volatile.

Vietnam: Counterfactual Simulation Under a New Policy Framework



Source: IMF Staff estimates.

E. Policy Implications and Conclusion

19. First, systematic FX interventions have significantly contributed to stabilizing the economy in Vietnam under a weak commitment to IT. Based on the estimation over the last two decades, the FX interventions have contributed to stabilizing the nominal FX rate, inflation and output growth, as in many other countries (Fratzscher et al. 2019). Also, the policy exercise implies that the systematic FX intervention responding to the nominal FX rate is more effective than the non-systematic FX intervention.

20. Second, with a stricter commitment to IT, the FX intervention may play a less important role for stabilizing the economy. FX interventions in Vietnam have stabilized the economy mainly by cutting the amplification of the domestic monetary shock through the FX market, rather than by mitigating the effects of external shocks directly. Hence, if they can appropriately mange adverse effects of the domestic monetary shock by committing to a credible and strict IT regime, they do not necessarily have to intervene to the FX market for stabilizing the economy.

21. Third, given other benefits of FX flexibility, the SBV should gradually introduce FX flexibility as they establish their credibility for the commitment to IT. The analysis in this paper is based on a simple and stylized DSGE model and misses many other important benefits of a flexible FX rate system as a shock absorber. As recently shown by Obstfeld et al. (2017), the countries with a floating FX regime have been more resilient to external shocks, particularly global financial shocks. Given those benefits of a floating FX regime, which are absent in the model here, it may be better for the SBV to gradually introduce FX flexibility in the process of modernizing the monetary policy framework toward IT, as they establish their credibility for the commitment to a stricter IT regime.

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Appendix VI. Priorities for Improving the Business Climate[1]

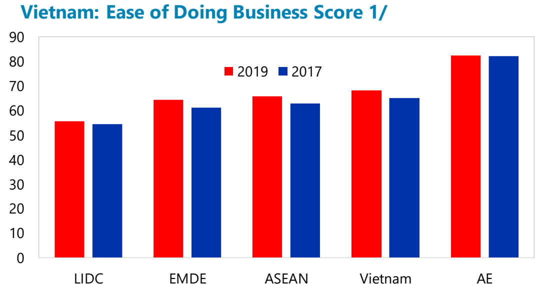
1. **Reforms launched in Vietnam since 1986 led to a multi-decade transformation, boosting inclusive growth and living standards across the country.** The government elected in 2016 committed to modernization, macroeconomic stability, shrinking the role of the state, fighting corruption and accelerating administrative reform to foster sustained private sector-led growth. To this end, it has initiated measures to improve the operation of the state, strengthen banks and SOEs, improve the business climate, tackle corruption, further open up its economy through significant free trade agreements, and upgrade its soft infrastructure (data, transparency, institutions, regulations). The IMF, World Bank and other agencies have supported this effort through training and technical assistance. The government's commitments under international agreements have also helped preserve the momentum for reforms.

2. **However, economic distortions and substantial weaknesses in the business climate remain.** They reflect, in part, legacy issues in state-owned enterprises (SOEs) and the banking system, a large state footprint in the control and allocation of factors of production such as land and credit, capacity constraints which slow the execution of the complex reform agenda, and complications arising from excessive decentralization. Going forward, the following areas are priorities for reform:

A. Reducing State Footprint

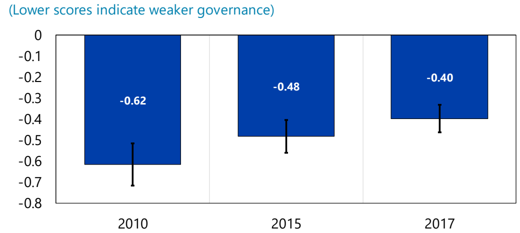
3. **The government's commitment to private sector led growth has helped improve the business climate.** Vietnam's regulatory quality and ease of doing business has been generally improving over the years, reflecting the elimination of numerous administrative measures to level the playing field between the private sector and the state. However, structural problems in the land and credit markets and the still-large SOE sector remain obstacles to the private sector. Moreover, while the regulatory burden has lightened significantly, implementation challenges, especially at the local and provincial levels, remain to be alleviated. Significant regulatory barriers to foreign and domestic private sector ownership should be further reduced to strengthen links between the domestic

Vietnam: Ease of Doing Business Score 1/



Source: Doing Business, World Bank.
1/ The ease of doing business score measures the gap between a particular economy's performance and the best practice. 0 represents the lowest and 100 represents the best performance.

Vietnam: Regulatory Quality 1/
(Lower scores indicate weaker governance)



Sources: Worldwide Governance Indicators, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank), 2017.
1/ Score ranges from -2.5 (lowest) to 2.5 (highest). Use of these indicators should be considered carefully, as they are derived from perceptions-based data. The vertical line for Vietnam indicates the lower and upper bound estimate based on 90 percent confidence interval.

[1] Prepared by Angana Banerji (APD).

enterprise and FDI sectors, improve competition, and raise productivity through the transfer of, and investment in, technology and expertise in the domestic economy.

- **Land.** Land ownership is concentrated in state hands because the Vietnamese constitution deems that land is owned by the public and managed on its behalf by the state. According to World Bank (2016), land-use rights issued to private individuals may be annulled in the national interest after compensation. The legal framework for individual rights to land use is subject to numerous, overlapping laws and implementing regulations and overlapping mandates at all levels of the government, fostering inefficiency. In the absence of a well-established market for trading land-use, state agencies use ill-defined administrative procedures, and land administrative price are decided by local administration from time to time resulting in below-market prices. Moreover, non-market-based principles for land-use reclassification by local administrations results in below-market compensation. The 2017 UN survey reported some recent improvement in the level of land-related bribes,[2] but reportedly the tolerance of bribes increased slightly as did the average amount that would trigger a complaint (UN 2017).

  Land ownership and leasing should be reformed to reduce concentration in state hands and competitive land auctions should become the norm. A land use market should be developed, with greater clarity and simplification of regulations and mandates across various levels of government. The ongoing review of land use measures by the Central Institute for Economic Management should keep these considerations in mind.

- **Credit.** Access to credit is affected by bank-by-bank credit growth ceilings established by the SBV, government guidance on the sectoral priorities for bank lending, capital shortfalls in state-owned commercial banks (SOCBs) which comprise a large share of the banking system and a still-significant—though declining—outstanding share of credit to the SOE sector (which includes evergreened non-performing loans).[3] Gaps in an otherwise adequate legal framework for supervision (2013 IMF FSAP)—such as the lack of clear powers to obtain overall information from holding companies, sister companies and other affiliates or the use by the supervisor of qualitative judgment in safeguarding the safety and soundness of the banks operating in Vietnam and no legal provisions granting full access to banks' board, management, and staff—hamper risk-based lending and supervision. Data gaps also constrain supervision and risk assessment.

  The banking system and risk-based supervision need to be further strengthened in the lead up to the transition to Basel II by January 1, 2020. SOCBs should be recapitalized quickly and managed at arms-length. Required dividend payments to the budget should be reduced and fresh capital injected using government funds. To help SOCBs recapitalize with new equity issues, state ownership should be reduced below 65 percent and foreign ownership limits raised. The capacity

[2] For example, the percentage of citizens directly experiencing bribery when applying for land use rights certificates fell from 23 percent in 2016 to 17 percent in 2017.

[3] According to the 2016 World Bank report "Vietnam 2035", political connections play an important role in determining access to credit.

to proactively manage financial sector risks should be improved, including by closing regulatory gaps to best practices. To better monitor vulnerabilities, data quality on loan classification, disaggregated credit and banking sector and corporate exposures, and real estate markets should improve. Closing these gaps requires a comprehensive strategy spanning multiple agencies with fragmented responsibilities for data collection and supervision. Broadening the required application of international accounting and auditing standards would improve transparency and help attract foreign capital for recapitalization needs.

- **SOEs.** Recent reforms seek to further rationalize the role of SOEs in the economy. The legal framework for equitization, divestment and reform of SOEs was revamped with the creation of an independent State Capital Management Committee (SCMC) to oversee all large SOEs to improve accountability and efficiency, while leaving management and regulation with line ministries and regulatory bodies. Several large and profitable SOEs in non-strategic sectors are slated for divestment in 2016–20, but the momentum slowed after 2017. Revisions to the Law on Securities, which are under consideration and expected to be passed in 2019, propose the removal of foreign ownership limits (FOLs) and 100 percent foreign ownership for public companies in sectors not considered critical to national security.

  The creation of the SCMC to separate state ownership and regulatory authority of SOEs is welcome. Regulatory entities must operate at arms-length from the government, enterprises and interest groups and be independent but accountable. SOEs should be operated based on hard budget constraints; reliable, timely and mandatory disclosures of financial statements based on improved accounting standards should help improve transparency, accountability and fiscal discipline (World Bank, 2016). In addition to internal audits, independent external audits should be conducted in line with International Standards on Auditing. Removing further administrative price controls and a dividend policy that also appropriately balances the medium-term financial health of the company with the delivery of its long-term social goals would be necessary. Equitization and divestment of SOEs should proceed as planned. To facilitate divestment, the State Capital Investment Corporation (SCIC) should have adequate capital and greater legal clarity regarding the transfer of SOEs to the SCIC is needed. Allowing 100 percent foreign ownership in public companies which are not critical to national security would be desirable.

B. Modernizing State Functions

4. Economic reforms and modernization has continued, helped in part by Vietnam's commitments under new and older free trade agreements such as the CPTPP, EU-FTA. Nevertheless, there is ample scope for further modernization, especially in:

- **Procurement.** The comprehensive procurement framework in Vietnam provides clear instructions on how and when to apply various procurement methods, narrowing the circumstances and reducing the thresholds under which direct contracting can occur. However, the thresholds leave room for abuse through contract splitting. Direct contracting and single-bidder situations are common: almost 70 percent of all public contracts were directly contracted in 2017, accounting for about 13 percent of the total value of public contracts (IMF 2018a). The lack of an independent, widely-trusted, bidder complaint handling mechanism makes it difficult to uncover potential biases or rigging of the bidding process because complaints are ultimately reviewed and assessed by the procuring entity itself, and the lack of data on procurement complaints and resolution undermines the effectiveness of the process. Court cases are rarely resorted to as the process is costly and time consuming. Information systems to monitor and disclose procurement information have improved but remain incomplete. The Vietnam e-government procurement (e-GP) system, launched in 2015, to transition procurement from a paper-based system to an online process is not used widely (only about 2–3 bidders per package bidding electronically).

Ensuring more effective competition in public procurement should be a high-level reform priority for Vietnam in the context of improving public investment efficiency. Vietnam should minimize the cases of direct procurement to a low percentage by restricting single-bidding situations for major contracts under competitive procurement, removing the monetary threshold for direct contracting, and electronically procuring contracts more.

- **Monetary framework.** The SBV is committed to modernizing the monetary framework which currently relies on indicative credit growth and M2 targets and a stable exchange rate closely tied to the U.S dollar. The intention is to shift to targeting inflation as the nominal anchor in the context of a stable exchange rate, and gradually phase out credit growth targets as banks transition to Basel II capital standards starting in January 1, 2020. However, unlike other countries that have modernized monetary policy, the Vietnamese economy still features characteristics of a centrally planned economy, where the central bank is an integral component of the State (IMF 2017) and therefore follows government guidelines when formulating monetary policy. Transitioning to inflation targeting would require far-reaching reforms to establish a consistent and forward-looking monetary policy by modifying the SBV's institutional foundations and its policy and operational framework, allowing it to take policy decisions in a structured, systematic, and informed manner without government interference.

  IMF (2017) stressed the need for greater clarity on the SBV's mandate as well as operational independence but greater accountability of the SBV as a pre-requisite for transitioning to inflation targeting. Since the central bank charter assigns the SBV the objectives of fighting inflation and promoting economic development, establishing precedence between them is necessary to prevent the SBV from taking inconsistent policy decisions. Domestic price stability should be the SBV's overriding objective since there is consensus that monetary policy is not effective at affecting real variables, like output growth, in the long run, but can effectively provide a nominal anchor (IMF 2017).[4] Focusing the SBV mandate on domestic price stability would enhance monetary policy effectiveness, facilitate holding the SBV accountable and developing a coherent central bank communication.

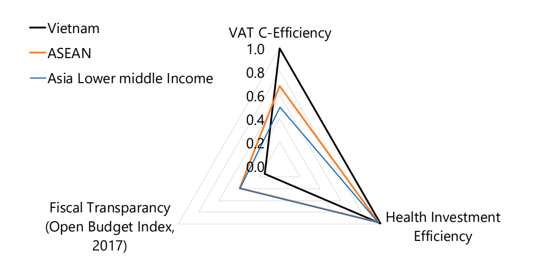
[4] This does not mean that the SBV would ignore output growth. In fact, maintaining low and stable inflation typically creates favorable conditions for long-term investment and economic growth.

Central bank operational independence helps bring credibility to monetary policy and is the backbone of inflation-targeting regimes. Relative to other emerging market inflation targeters, the SBV features low central bank independence and accountability as public policy decisions are centralized, and the SBV's mandate is influenced by the government's political goals. The SBV lacks both political independence—given that the SBV Governor is a cabinet member—and operational independence. As the SBV moves to inflation-targeting, the critical reform is to grant operational independence to the SBV (IMF 2017). In Vietnam, the SBV's operational independence is not clearly established, unlike in most central banks in the world, because the SBV Governor legally shares responsibility with the Prime Minister on the use of the monetary policy toolkit. As a first best scenario, the SBV Law should be amended to establish that the central bank is empowered to choose monetary instruments without government interference and to use them freely to achieve the inflation target. As a second-best scenario, this operational independence could be enshrined in the National Plan approved by the National Assembly. The SBV law could also clearly establish the rules under which the SBV provides advances to the government, explicitly prohibiting the provision of credit to the government (IMF 2017).

According to IMF 2017, there is also room for improving the SBV's accountability which is currently a shared responsibility: the Prime Minister directly reports to, or authorizes the Governor of the SBV to report to, the National Assembly on the annual implementation of monetary policy. Thus, in line with the operational independence that would be granted to the SBV, the Governor of the SBV should be responsible for reporting to the government and the National Assembly.

- **Soft infrastructure.** Vietnam must accelerate its push toward international standards for regulatory excellence, transparency and disclosure, including by improving data quality and timely publication. A collaborative and comprehensive approach is needed across all agencies to address data and analytical gaps, with greater public access to information to better communicate, educate and improve accountability. High priority areas include: collecting and releasing budget data according to GFSM2014 standards (IMF 2018b); public dissemination of the financial accounts of all state-owned enterprises (not just those of listed companies), extra budgetary funds and foreign exchange reserves; better data quality on external statistics (IMF 2018c), domestic and external debt of households and non-financial companies, including intra-company debts of foreign direct investment companies, and developing real estate price indices (IMF 2018d) would be important. Vietnam should establish a National Summary Data Page (NSDP) to allow users to access data, view metadata, and browse online databases. It is also important to further increase the transparency and governance of equity markets and bring them towards international standards,

Vietnam: Fiscal Governance Indicators



Sources: International Budget Partnership and; IMF staff calculations.

including by requiring public companies above a certain size to be listed in the stock markets and modernizing the legal framework and accounting standards to support Vietnam's move to emerging market status.

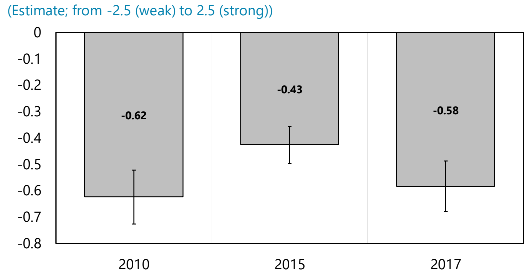
C. Control of Corruption

5. Since 2016, the government has started tackling grand corruption and several high-level corruption cases have been prosecuted with significant sentences handed down. A new anti-corruption law was adopted in late 2018 to strengthen the legislative framework for tackling corruption. The new law puts in place a more effective and efficient system for the declaration of income and wealth by all civil servants and the extended public sector to address issues related to conflict of interest and illicit wealth. The new law also requires greater collaboration and coordination with AML and credit institutions when illegal activities are detected.

6. Despite these efforts, Vietnam's average Control of Corruption (CoC) score deteriorated since 2015, (Figure), possibly reflecting a lag with which improvements are reflected in these indices.

Vietnam: Control of Corruption[1]

(Estimate; from -2.5 (weak) to 2.5 (strong))

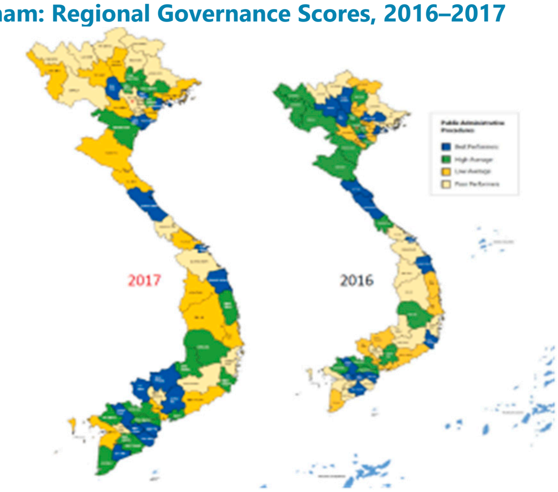


Sources: Worldwide Governance Indicators, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank), 2017.

[1] Lower score indicates weaker control of corruption and regulatory quality. The lines indicate the lower and upper bound estimate based on 90% confidence interval. CC short for Control of Corruption and RQ short for Regulatory Quality.

7. However, the Vietnam Provincial Governance and Public Administration Performance Index (PAPI) survey conducted annually by the UN paints a slightly more positive picture (Figure). The 2017 PAPI survey indicates progress across all regions in the following areas: transparency, vertical accountability, control of corruption in the public sector, public administrative procedures, and public service delivery. The largest improvements are in the perception and actual experience of the control of corruption in the public sector.

Vietnam: Regional Governance Scores, 2016–2017



Source: Vietnam Provincial Governance and Public Administration Performance Index (PAPI) survey; United Nations; and IMF Staff calculations.

8. Nevertheless, further progress is needed to improve governance so that Vietnam can catch up to its peers and reduce the cost of corruption.[5] Moreover, an emerging downside of the anti-corruption measures should be addressed as soon as possible, namely the perceptible rise in policy inaction and investment delays due to the chilling effects of anti-corruption initiatives on public sector policy decisions. In addition to the measures to modernize state functions and increase transparency discussed above, the policy priorities are as follows:

- **Anti-corruption.** The revamped 2018 anti-corruption law is a positive development as it clarifies and strengthens the legislative framework for combating corruption (including public access to asset declarations). Nevertheless, further improvements on the asset declaration system can be made to align with international best practices, such as a centralized repository of asset declarations, expanding the information covered in the asset declaration, and mechanisms for verification. To ensure credibility and public trust on genuine anti-corruption investigations, measures are needed to safeguard the independence of the Government Inspectorate of Vietnam—the ministerial-level agency empowered to inspect and combat corruption in accordance with the law—against undue political influence and accountability measures should be put in place to protect against abuse. The whistleblower protections could also be enhanced (e.g., by providing safeguards against retaliation). Moreover, specialized oversight agencies such as the State Audit of Vietnam, the Government Inspectorate, and ministerial and subnational Inspectorates, could be strengthened with greater autonomy, resources, and technical capacity (World Bank 2016).

- **Judiciary.** Judiciary reform is needed to improve the enforcement of contracts, strengthen legal interpretation, and facilitate resolution, restructuring and bankruptcy proceedings. The effectiveness of anti-corruption measures should be enhanced by strengthening the judiciary whose effectiveness is undermined by a heavy dependence on the executive (World Bank, 2016). Many aspects of the executive are outside judicial supervision and the courts are beholden to the executive for administering the court. Moreover, the size and staffing of the courts is increasingly inadequate for handling the growing size and complexity of cases it needs to oversee. Transitioning to a modern, independent and professional judiciary involves: greater disclosure of judgments and case records, clarifying the roles of judges as arbiters rather than participants in cases, and greater independence in the selection of members of the judiciary (World Bank 2016).

- **Accountability versus empowerment.** The legal framework needs to strike a better balance between holding the public sector accountable versus providing them the necessary legislative protection from criminal protection and appropriate guidance and freedom to perform their duties efficiently so as not to delay reforms, paralyze policymaking, and undermine productivity. First, in several areas (such as land use, public investment) greater regulatory clarity and simplicity is needed to reduce overlap and duplication across multiple agencies and jurisdictions

[5] In practice, anti-corruption prosecutions were hampered by the largely cash-based nature of transactions and limitations in the scope of the previous anti-corruption legislation which effectively did not cover high-level officials. Vietnam's Government Inspectorate report on a 10-year review of implementing Anti-Corruption law reported that damages caused by corruption exceeded an estimated US$2.6 billion.

to improve accountability. Second, policy targets and objectives should be realistic and sufficiently informed by technical expertise so as not to create perceptions of malpractice in the event overly optimistic political targets are missed. Finally, in line with international best practice, the legislative framework should explicitly incorporate adequate protection against criminal protection for public officials for good faith performance of their duties. For instance, to ensure compliance with Basel Core Principle 1.5, the legislative framework for bank supervision should explicitly incorporate adequate safeguards against unfounded criminal prosecution for public officials for good faith performance of their duties (IMF 2013). Similarly, legislative safeguards against criminal liability could be provided for tax officers (such as for tax assessments or risk-based auditing).

9. Anti-money laundering. The authorities are finalizing their national assessment of money laundering and terrorist financing risks, which shall form the basis for developing a national action plan. The AML/CFT framework and execution (including customer due diligence requirements for political exposed persons) should be strengthened in line with the FATF standards to address key country risks. The upcoming 2020 FATF assessment which will get underway in 2019 will focus on the effective implementation of legislative provisions and institutional frameworks.

,Appendix VII. Capacity Development Strategy[1]

A. Overview

1. Vietnam's resilient economy and growing downside risks provide an opportunity for Vietnam to accelerate reforms that aim to strengthen its institutions of economic management, ensure resilience to shocks, and promote investment and a higher rate of inclusive, sustainable growth. Capacity development from a wide range of partners is being deployed to achieve this institutional upgrade.

2. IMF technical assistance and training focuses on the Fund's core areas of expertise and is closely coordinated with surveillance priorities, as elaborated in the main text of the Policy Note for the 2019 Article IV consultation. The main priorities of Fund CD are three-fold.

- Modernize monetary and financial sector institutions and management, by moving gradually toward greater exchange rate flexibility and an inflation targeting regime and away from targeted credit and strengthening bank balance sheets and financial risk assessment.

- Strengthen Vietnam's fiscal systems and institutions, by improving fiscal reporting and macro-fiscal analysis, including assessment of fiscal risks associated with PPPs, aging, natural disasters and other sources. Implement PIMA recommendations to improve public procurement and other aspects of public financial management.

- Third, improving the quality of data across the board to prepare Vietnam for formal entry into Emerging Market status. This entails improving the quality (coverage, accuracy, timeliness, availability of metadata) of national income and product accounts, of monetary, financial and fiscal data, and of data provided by SOEs, EBFs, reserves.

Taken together, this broad CD agenda will help to improve the business climate, accountability and governance, raise investment and reduce the external surplus.

B. Capacity Development in 2018–19

3. Over the years, IMF surveillance, training, and technical assistance have supported the above policy objectives, along with partner institutions such as the World Bank and ADB. Key activities in 2018–19 include the following:

- **Modernization of monetary framework.** Given the policy emphasis on greater exchange rate flexibility and the adoption of inflation as the nominal anchor, the IMF facilitated cross-country knowledge exchange with Vietnamese policymakers on inflation targeting in 2018. Senior external experts from the Czech Republic, Israel, Peru, and Thailand shared their firsthand experience regarding such a transition, including the costs and benefits of greater exchange rate

[1] Prepared by Angana Banerji (APD).

flexibility, policies to address dollarization, and minimize the implications for the financial sector. This was followed by a peer-to-peer exchange regarding actual practices and policy considerations among high level inflation-targeting ASEAN central bank officials and external experts, and a one-day IMF workshop in Hanoi on forecasting. The State Bank of Vietnam (SBV) has since committed to inflation targeting and is gradually introducing greater two-way flexibility in the exchange rate within a ± 3 percent band. An ICD-MCM mission is about to conduct a scoping mission in March 2019 to assess the readiness and commitment of the SBV to undertake customized training (CT) on the development of a Forecasting and Policy Analysis System (FPAS) as part of a phased approach to modernizing SBV's monetary policy framework and operations.

- **High quality fiscal adjustment.** IMF surveillance has stressed the need for high quality fiscal consolidation to improve debt sustainability by improving tax administration, broadening the tax base, expanding high-priority public investment while moderating current spending. Policy recommendations drew upon the priorities laid out in past and ongoing IMF technical assistance and review of tax policy and administration, staff analysis on fiscal rules, and the assessments of the World Bank and Asian Development Bank in specific areas (e.g., civil service and pension reforms). An IMF Public Investment Management Assessment was completed in 2018 with recommendations on better prioritizing, executing, and improving the transparency and governance related to public investment, PPP and procurement in Vietnam. The IMF also provided detailed recommendations regarding a revised public investment law that will soon be considered by the National Assembly. Finally, at the request of the authorities, the IMF helped organize a regional workshop on infrastructure in Hanoi in January 2019.

- **Statistics.** IMF technical assistance continues to support the authorities' initiatives to improve the coverage, quality and timeliness of statistics in the following areas: transitioning to GFSM 2014 for the preparation of fiscal accounts; improvements in price, national accounts and external sector statistics (including debt); developing a real estate price index; and, improving the quality of high frequency indicators. In addition, it is assisting the authorities in building a National Summary Data Page (NSDP) for Vietnam and developing a road map to help the authorities achieve their goal of transitioning to SDDS in 2020.

- **Training and institution building.** The IMF continues to provide training in a number of ways to build capacity and help garner traction for its policy advice: (i) both technical assistance and surveillance incorporate elements of training by grounding policy assessments and advice against cross-country experience and international best practices, and by providing supporting analysis; (ii) workshops (such as on capital flow management and infrastructure investment); (iii) dedicated training and technical assistance (medium-term debt strategy; debt sustainability framework; PFM; reserve management); and (iv) regional workshops and peer to peer learning (as discussed above).

C. Priorities for 2019–20

4. Going forward, the priorities for capacity building will remain broadly in line with those discussed above: modernization of the monetary framework; improving debt sustainability, fiscal transparency, and effective fiscal policies and institutions for taxation, public investment, and procurement; raising the bar on data quality and regulatory standards. Capacity building in these areas will also help inform the authorities' views as they develop their next multi-year reform strategy plan for 2021–30. Moreover, as the authorities begin to implement the recommendations of IMF technical assistance, there may be need for dedicated technical support and training, and additional technical assistance in several areas. In these efforts, IMF teams will closely cooperate with the World Bank, as needed, to ensure coherence in recommendations and to avoid duplication of efforts.

Monetary and exchange rate policy. Following an initial assessment of the SBV staff's technical capacity to understand, operate and implement forward-looking monetary models, the IMF will provide customized training based on a roadmap for building that capability. Analytical background work for the 2019 Article IV on the monetary transmission mechanism in Vietnam, credit gap estimates, and the optimal inflation rate that should be targeted by the SBV in 2020 and over the medium-term, will help should support the IMF's continued emphasis on the need for modernization of the monetary framework.

- **Fiscal policy and sustainability.** An important focus of the IMF's work will be to engage with, review, and support the authorities as they undertake structural reforms in tax policy, tax administration, and public investment. To make the case for such reforms, the 2019 IMF surveillance will (i) assess the budgetary impact of policy changes and incorporate them into the medium-term fiscal strategy and debt sustainability assessments; and (ii) undertake a more comprehensive and longer-term fiscal analysis than has been the norm. The latter will also illustrate the fiscal implications of undertaking a comprehensive assessment of general government balance sheets, including granular information on extra budgetary funds and budget financing. Building on staff analysis of expenditure needs to meet Sustainable Development Goals (SDGs) on education, health and infrastructure by 2030, IMF surveillance will present a long-term debt sustainability analysis to illustrate the growing budgetary pressures from ageing, [climate change], and achieving SDGs. Technical assistance to review the performance of cash management and treasury management systems to inform their next long-term reform strategy are underway.

- **Strengthening the financial sector.** The SBV's financial sector supervisory and risk management capacity should be further strengthened to (i) ensure effective supervision as the banking system prepares to transition to Basel II by January 1, 2020, and (ii) address emerging issues such as Fintech and related data management, central bank digital currency and particularly, monetary prudential policies options for cyber risk management. Given the authorities' interest in IMF support in these areas, a capacity development strategy will be developed in these areas, [including updating some aspects of the 2013 FSAP such as the compliance of the supervisory regulatory framework with Basel Core Principles, framework for stress testing bank balance sheets and liquidity and crisis management frameworks]. Given the World Bank's involvement in supporting SBV's financial sector surveillance, a capacity building strategy would need to be developed collaboratively to build synergies and avoid duplication.

- **Improving soft infrastructure and governance.** IMF surveillance and capacity building efforts will continue to support the authorities' goal of upgrading their statistics and regulatory frameworks to international best practices. Building on an assessment of governance under the IMF's GAT framework, the following areas are high priority:

- **Anti-corruption framework and AML/CFT.** With the help of IMF technical support, further improving the new anti-corruption framework to international best practices would be desirable. Moreover, in addition to strengthening the AML/CFT framework (including customer due diligence requirements for political exposed persons) in line with the FATF standards to address key country risks, improving actual implementation would be crucial for the planned 2020 assessment by FATF.

- **Transitioning to SDDS in 2020.** IMF surveillance and technical assistance will continue to emphasize the need for greater transparency and disclosure to regional and international standards as crucial to achieving their goal of moving to SDDS by 2020. It will support timely disclosure of key national account, fiscal and monetary statistics through the NSDP.

- **Fiscal transparency.** Producing and disseminating fiscal statistics according to the GFSM, on which IMF technical assistance has been ongoing, would be crucial for improving fiscal transparency and accountability and the quality of fiscal analysis. Full disclosure of the financial accounts of extra budgetary funds and externally audited balance sheets of state owned enterprises, government financing and assets in the banking system, and better and more transparent procurement systems, would be critical.

- **Monetary and financial statistics.** To proactively detect and manage financial sector risks, data quality on credit and sectoral credit breakdowns, real estate markets and exposures needs to be improved. To that end, technical assistance on developing a property price index, improving the reporting of monetary statistics to the IMF, improving external sector and debt statistics will remain high priorities.

Vietnam: Multi-Year Surveillance and Capacity Building Priorities

Issues to Cover	Macro critical	Traction	Article IV Consultations				Ongoing and Planned Capacity Development
			Past	2019	2020	2021	
1. Traditional issues (Real, Fiscal, Balance of Payments, Monetary, External Assessment, Debt Sustainability, Financial Stability)	High	Medium	√	√	√	√	√
Issues for Further Integration							
2. Macro-financial Issues							
2-1. Capital Inflows	Medium	Medium	√	√	√	√	
2-2. Monetary and exchange rate policy	High	Medium	√	√	√	√	√
2-3. Banking Sector Soundness	High	Medium	√	√	√	√	World Bank
2-4. Balance Sheet Currency Mismatch	Low						
2-5. Macroprudential Policy	High	Low	√	√	√	√	World Bank
2-6. Financial Supervision and Regulation	High	Low	√	√	√	√	World Bank
2-7. Currency Substitution and De-dollarization	Medium		√	√	√	√	
3. SDGs/FfD Commitments							
3-1. Domestic Revenue mobilization	Medium	Medium	√	→	→	→	√
3-2. Infrastructure Investment	High	Medium	√	→	→	→	√
3-3. Building Policy space/economic resilience	High	Medium	√	→	→	→	√
3-4. Environmental sustainability, equity/inclusion	High	Medium	√	→	→	→	World Bank
3-5. Domestic financial market promotion	High		√	→	→	→	World Bank
3-6. Data enhancement	High	High	√	→	→	→	√
4. Fund's New "Core" Issues							
4-1. Gender	Low		√				
4-2. Macrostructural	High	Medium	√	→	→	→	World Bank
4-3. Climate Change and Sustainability	High	Medium	√	→	→	→	
4-4. Governance	High	Medium	√	→	→	→	√

Key: √covered; → follow up on previous year;

Appendix VIII. Progress Against IMF Recommendations[1]

Policies	2018 Article IV Consultations Recommendations	Actions since 2018 Article IV Consultations
Fiscal Policies	Continue the gradual consolidation of the public finances by lowering the budget deficit and public debt. Improve the quality of fiscal adjustment by undertaking reforms in revenue policy and administration to broaden and diversify revenue bases.	The authorities continued to adhere to lower budget deficit targets and to grant guarantees sparingly. Public debt has declined significantly. The authorities raised environmental and excise taxes but have refrained from broad revenue policy reforms (such as raising VAT rates), which have met resistance. On the other hand, the authorities continue to improve revenue administration.
	Review current spending with a view to reducing the wage bill and undertaking civil service reforms. Protect capital expenditure and raise its efficiency, including by undertaking a Public Investment Management Assessment (PIMA). Improve public financial management and fiscal data, accounting and reporting.	The authorities are gradually lowering head count in the civil service and tightening non-essential current spending. Increases in retirement ages for men and women are being reviewed by the NA. Additional efforts will needed as outlined in the staff report. The PIMA has taken place, coordinated by the CEC, and its recommendations are being reviewed with implementation expected in 2019-20. Treasury operations are being reviewed with assistance from IMF TA. The authorities agree in principle that the coverage of the fiscal accounts needs to be expanded and become more detailed.
Monetary Policy	Tighten monetary policies, raise interbank rates and reduce credit growth targets. Begin to modernize the monetary framework by anchoring monetary policy on price stability, allowing greater exchange rate flexibility and phasing out credit growth targets.	Monetary policy was tightened, interest rates rose to close to the repo rate and credit growth targets were further tightened as discussed in the staff report. The SBV has started the multiyear process of modernizing its monetary framework with IMF technical support.
Financial Sector Policies	Further strengthen the banking system and its supervision by recapitalizing state-owned commercial banks and managing them at arm's length. Speed up NPL resolution by finalizing the implementing regulations of Resolution 42.	Recapitalization of state-owned commercial banks is a priority for the authorities. Modalities are now being internally discussed on a bank by bank basis. The introduction, in January 2020, of Basel II capital requirements is accelerating the process. The implementation of Resolution 42 has been accelerated, facilitating disposal of collateral, asset restructuring and NPL disposal.

[1] Prepared by David Corvino (APD).

	Improve the capacity to manage financial risk.	The SBV is improving its capacity to conduct stress tests and produces financial stability reports (not published). A high-level committee has been set up to monitor system- wide financial risks.
Structural policies	Develop non-bank, long-term financing to support investment	A domestic credit rating agency is being created and the legal and institutional framework for capital and securities markets is being strengthened.
	Continue to shrink the economic role of the state and address governance and data gaps.	The equitization of large SOEs in non-strategic sectors identified in the 2016-20 plan continues. Regulatory burdens continue to be lightened, including a new legal framework for SMEs. A new public investment law was introduced. The authorities' fight against corruption continues. Data gaps are being addressed on an ongoing basis. The authorities reviewed and will revise the national accounts and balance of payments data, with IMF technical support.
	Lower the intensity of dirty fossil fuels and raise the contribution of renewables and natural gas	New environmental taxes were enacted and new investments to promote liquified natural gas are in the pipeline.

INTERNATIONAL MONETARY FUND

VIETNAM

June 4, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of April 30, 2019)

Membership Status

Joined: September 21, 1956; Article VIII

General Resources Account

	SDR Million	Percent of Quota
Quota	1,153.10	100.00
Fund holdings of currency	1,153.10	100.00
Reserve position in Fund	0.01	0.00

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	314.79	100.00
Holdings	269.77	85.70

Outstanding Purchases and Loans: None

Latest Financial Arrangements

In millions of SDRs (mm/dd/yyyy)

Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
ECF[1]	04/13/2001	04/12/2004	290.00	124.20
ECF[1]	11/11/1994	11/10/1997	362.40	241.60
Stand-By	10/06/1993	11/11/1994	145.00	108.80

[1] Formally PRGF.

Projected Payments to Fund

In millions of SDRs (based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2019	2020	2021	2022	2023
Principal					
Charges/interest	0. 35	0. 48	0. 48	0. 48	0. 48
Total	**0.35**	**0.48**	**0.48**	**0.48**	**0.48**

Exchange Arrangement

The exchange rate arrangement is classified as defacto stabilized. The de jure arrangement is managed floating. The State Bank of Vietnam (SBV) is gradually increasing exchange-rate flexibility. In August 2015 it widened the VND/USD trading band to +/-3 percent from +/-1 percent while devaluing the central parity by one percent. In January 2016 it announced the VND/USD rate would be adjusted daily rate based on (i) the previous day's weighted average dong/USD exchange rate; (ii) a weighted average of movements in dong exchange rates vis-à-vis seven other important trading partners' currencies; and (iii) domestic macroeconomic conditions.

Vietnam maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for those exchange restrictions imposed for security reasons of which Vietnam has notified the IMF pursuant to Executive Board Decision No. 144- (52/51), 8/14/52.

Article IV Consultations

Vietnam is on a 12-month consultation cycle. The previous Article IV consultation was held in Hanoi during April 3–19, 2018, and was concluded by the Executive Board on June 19, 2019.

Technical Assistance

In 2018, a high level MCM-APD workshop was held to share cross-country experiences regarding modernization of monetary policy framework with Vietnamese policymakers. At the authorities request, FAD conducted a Public Investment Management Assessment (PIMA).

In 2019, FAD provided TA on strengthening Vietnam's Treasury cash management. MCM organized a scoping mission aiming at preparing a comprehensive training on Forecasting and Policy Analysis System (FPAS). STA provided TA on Government Finance Statistics, National Accounts, Property Price Index, high frequency indicators and e-GDDS. In addition, CDOT provides TA on external sector statistics and STI organizes trainings.

In recent years, Vietnam has received TA in the areas of statistics (government finance, external sector, price, and national accounts), reserve management, debt management, bank resolution, stress testing the banking sector, and monetary operations and liquidity management. From December 2008 to January 2012, a resident advisor assisted the authorities in improving banking supervision. The IMF-World Bank Financial Sector Assessment Program was undertaken during 2012–13.

Resident Representative

Starting June 2019, Mr. François Painchaud will be the Resident Representative for Vietnam and Lao P.D.R., based in Hanoi.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank: http://www.worldbank.org/en/country/vietnam

Asian Development Bank: https://www.adb.org/countries/vietnam/main

MAIN WEBSITES OF DATA

State Bank of Vietnam (www.sbv.gov.vn)

Exchange rates

Interest rates

Balance of payments

Credit to the economy

Money Market Operation

Ministry of Finance (www.mof.gov.vn)

Government budget

Customs data

Public Debt Bulletin

General Statistics Office of Vietnam (www.gso.gov.vn)

Consumer Price Index

National accounts

Population and Employment

Investment and Construction

Socioeconomic information

STATISTICAL ISSUES

(As of May 1, 2018)

Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings, but is broadly adequate for surveillance. Most affected areas are financial sector, national accounts, government finance, and external sector statistics.

National accounts: The General Statistics Office (GSO) provides quarterly (cumulative) and annual data on GDP by type of economic activity and by expenditure (both in current and constant prices), and monthly and annual data on external trade, industrial output, retail sales, and prices. Successive STA technical assistance missions in December 2016 and August 2017 recommended that the GSO prioritize improving the Quarterly National Accounts (QNA) statistics. The GSO produces cumulative QNA estimates for the first three quarters of the year and the fourth quarter estimate is a residual. Instead, the GSO should compile discrete and independent quarterly GDP, using consistent data sources and methods. The data collection practices and coordination between data collection agencies could be strengthened and the compilation of national and provincial estimates should be centralized at GSO. The National Accounts base year is 2010 and, under the 2011–2020 Statistics Department Strategy, Vietnam plans to implement the *2008 SNA* by 2020.

Prices statistics: The CPI methodology is broadly in line with international standards. The GSO recently implemented the rental equivalence approach for the treatment of owner occupied housing although the sample of rentals could be rotated on an annual basis and there is a need to improve the weights for owner occupied housing during the next CPI update in 2019. Price collection for the CPI could also be expanded to include more days throughout the month to better reflect price changes for the reference period. Monthly producer and trade price indices are published quarterly. The GSO has begun work towards compiling residential property price indexes and will receive STA technical assistance under the new D4D (Data for Decisions) project.

Government finance statistics: Government operations data reflect the consolidated operations of the state budget, which cover all four levels of government (central, provincial, district, and commune). However, data exclude quasi fiscal activities of the central bank (and state-owned enterprises (SOEs)), and extra-budgetary funds, among which are the Social Security Fund, Enterprise Restructuring Fund, Development Assistance Fund, Export Support Fund, local development funds, and the Sinking Fund (for repayment of on-lent funds), for which data are not compiled/disseminated on a regular basis. Compilation is on a cash basis for final annual data, but varies for provisional data depending on their source. As a result, government financing data, in particular domestic bank financing, cannot be reconciled as reported in the fiscal and monetary accounts. The World Bank and the IMF have recommended improving the coverage of fiscal data and aligning definitions with the *GFSM 2014*. The authorities expect to provide GFSM 2014 consistent data starting in 2018.

Monetary statistics: The State Bank of Vietnam (SBV) reports monetary data for the central bank and other depository corporations to the IMF's Statistics Department (STA) with monthly periodicity, using old report forms with very limited information. STA has encouraged the SBV to develop a reporting scheme providing a comprehensive breakdown of data by counterparties and by currency of transaction, which will facilitate the migration to the standardized report forms.

External sector statistics: Balance of payments statistics rely on limited source data, resulting in gaps in several areas of the external accounts (current, capital, and financial). Starting from 2013 data, the authorities are reporting balance of payments in BPM6 format, however timeliness of the data remains an issue. Recent STA TA work via TAOLAM was focusing on improving data quality on foreign direct investment, development of international investment position (IIP) and external debt. The following observations and recommendations from previous STA TA missions remain: (i) the available resources are not sufficient to ensure effective implementation of an International Transaction Reporting System; (ii) FDI survey should be conducted annually and incorporated into compilation; (iii) further improvements are still needed in the treatment of goods for processing in line with BPM6, improvement of remittances estimates, and further study on unrecorded trade in gold; (iv) there is a need to address significant errors and omissions in the balance of payments, which could be related to changes in household holdings of foreign exchange in cash; (v) international reserves transactions need to be distinguished from valuation changes; (vi) improve timeliness and dissemination format of external sector statistics, including IIP.

Financial Soundness Indicators: Vietnam reports 10 of the 12 core financial soundness indicators (FSIs), 7 of the 13 encouraged FSIs for deposit takers, and one FSI for real estate markets with semi-annual frequency for posting on the IMF's FSI website. Data are reported with lag of more than two quarters.

Data Standards and Quality

Vietnam became a participant in the General Data Dissemination System (GDDS) in September 2003, which was superseded by the enhanced GDDS (e-GDDS) in 2015. An STA mission visited Vietnam in April 2016 and assisted the authorities to develop a National Summary Data Page (NSDP) in preparation for the e-GDDS implementation. The mission recommended that Vietnam adopt a strategy to make progress through the e-GDDS thresholds toward the Special Data Dissemination Standard (SDDS). No data ROSC are available.

Reporting to STA

Currently, no government finance statistics (GFS) are reported for publication in the IMF's *Government Finance Statistics Yearbook (GSY)* or *International Financial Statistics (IFS)*. Annual GFS data through 2004, excluding extra-budgetary funds and social security funds, based on the 1986 GFS format, have been reported for publication in the *GFSY*. No sub-annual fiscal data have been reported for publication in *IFS* since 2001.

Table of Common Indicators Required for Surveillance

(As of May 20, 2019)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	May 2019	5/20/19	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Feb. 2019	4/23/19	M	M	N/A
Reserve/Base Money	Jan. 2019	5/3/2019	M	M	N/A
Broad Money	Jan. 2019	5/3/2019	M	M	N/A
Central Bank Balance Sheet	Jan. 2019	5/3/2019	M	M	N/A
Consolidated Balance Sheet of the Banking System	Jan. 2019	5/3/2019	M	M	N/A
Interest Rates[3]	May. 2019	5/20/19	D	D	N/A
Consumer Price Index	Apr. 2019	5/7/19	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	Dec. 2018	Mar. 2019	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[6]	2018	Mar. 2019	A	A	A
External Current Account Balance	Q3 2018	12/3/18	Q	Q	Q
Exports and Imports of Goods and Services[7]	Apr. 2019	5/15/19	M	M	M
GDP/GNP	Q1 2019	4/3/19	Q	Q	Q
Gross External Debt	2018	Mar. 2019	A	A	A
International Investment Position[8]	...	...	N/A	N/A	N/A

[1]Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); and Not Available (N/A).
[2]Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency, but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[3]Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4]Foreign, domestic bank, and domestic nonbank financing.
[5]The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.
[6]Including currency and maturity composition.
[7]Services data available on an annual basis.
[8]Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Statement by Alisara Mahasandana, Executive Director for Vietnam and |Zeno Ronald Ruiz Abenoja, Senior Advisor to the Executive Director
June 19, 2019

Introduction

1. On behalf of the Vietnamese authorities, we would like to thank the IMF's Article IV mission team for the candid and constructive policy discussions as well as for their objective and comprehensive assessment. The authorities were encouraged by staff's positive assessment of the Vietnamese current economic situation, and took note of variance in views, particularly on Vietnam's external position in 2018.

2. In the context of rising trade tensions, heightened uncertainties and downside risks in the global economy, the Vietnamese economy in 2018 and early 2019 remained resilient, supported by strong macroeconomic fundamentals. Appropriate policy framework together with sound and timely policy responses will help ensure sustained economic growth in 2019. Our authorities remain vigilant against near-term risks and continue to be committed towards sound policies and upgrading institutions of macroeconomic management in order for Vietnam to successfully navigate its transition to upper middle-income status by 2030.

Latest economic developments and outlook

3. Our authorities remain committed to macroeconomic stability and private sector-led growth. They agree with staff's assessment that solid growth with low inflation will continue even as credit and monetary policies are becoming more prudent. In 2018, the economy remained strong and resilient with GDP growth of 7.1 percent, slightly above the 6.7 percent target, supported by robust external performance, firm domestic demand and a rebound in industrial production and construction. The momentum continued in the first quarter of 2019. The broad-based expansion is fueled by healthy growth in incomes and domestic consumption and by strong trade, tourism and remittances. Manufacturing is surging, the trade surplus has widened, and direct investment inflows remain strong. Headline inflation averaged 3.54 percent with core inflation of 1.48 percent in 2018. In Q1 2019, inflation increased slightly to 2.63 percent (ayoy), due to fuel and administrative services price increases but remains below the authorities' 4.0 percent target.

4. For 2019, the authorities project the economy to sustain its strong growth momentum driven by sound economic fundamentals, including gains in productivity, and more effective investment, particularly public investment. The authorities believe that the growth target of around 6.8 percent is achievable Headline inflation for 2019 is projected to be well-anchored at around 3.7 percent, below the target of 4.0 percent, and core inflation at 1.7 - 2.0 percent (yoy). This would be supported by a wide-range of administrative measures and structural reforms to streamline administrative and licensing procedures and to further ease the domestic private sector's access to land and credit that would help level the playing field and boost potential growth.

5. The authorities concur with staff that downside risks to growth outlook have risen. As

a small and highly open economy, global trade tensions and elevated trade policy uncertainty will likely weigh on the Vietnamese economy through trade, financial and expectations channels. Fully aware of these risks, the authorities, therefore, has been pursuing reforms and policies to reduce vulnerabilities and build buffers. The fiscal adjustment will be accelerated and its quality improved to help narrow infrastructure and social spending gaps and meet the coming challenge of rapid aging. Further modernization of monetary framework will be pursued while the supervision of the banking sector will be upgraded. The recapitalization of banks will continue while the adoption of Basel II standards is scheduled for 2020. The management of SOEs will be further strengthened to allow for privatization of government- owned companies in non-strategic sectors. Data provision and dissemination will also be further enhanced. Additional efforts are needed to improve governance and fight corruption, including through greater fiscal transparency and better public investment management, as well as a stronger AML/CFT framework and execution.

Fiscal policy

6. The Vietnamese authorities remain committed to significant fiscal consolidation. The state budget deficit is expected to stabilize at 3.46 percent of GDP in 2018, lower than the target. A strong economy and better tax administration helped buoy 2018 revenues, while tight disbursement of public investment contained spending. Gross public and publicly guaranteed debt declined to 58.4 percent of GDP at end of 2018 and is expected to further fall below 50 percent of GDP by end-2024. Growing reliance on non-debt creating deficit financing, including privatization, lengthening of debt maturities, and low long-term interest rates are all expected to help contain debt service costs. The authorities agree with staff's assessment that Vietnam currently has some fiscal space given the downward sloping debt path and continued strong fundamentals and the quality of fiscal consolidation should be further improved.

7. For 2019, the authorities are committed to contain public debt of around 61.3 percent of GDP and budget deficit of less than 3.6 percent as targeted. To do so, the authorities plan to implement fundamental tax reform to broaden tax bases and reduce informality of incentives. In 2019, the authorities will be taking necessary measures to preserve strong revenue mobilization in the context of declining ODA and oil revenues. These would include the envisaged broad review of tax policy, tax base widening, and revision of tax laws (VAT, excises, and CIT). In this regard, the authorities appreciate the Fund's technical assistance tosupport the authorities' efforts in reviewing the current tax laws and strengthening tax administration. On the expenditure side, the authorities confirm that urgently needed public investments would be increased while rationalizing the public sector wage bill and improving public investment efficiency. The reforms recommended by the recent PIMA mission will be carefully considered for implementation at an opportune time.

8. The authorities' medium-term fiscal strategy aims to contain the budget deficit to3.8 percent of GDP by 2020. The strategy involves drawing up a fiscal strategy to deal with the longer-term fiscal challenges related to rapid population aging which is projected to set in around 2030-35, and the adoption of high-quality, sustained

measures that are balanced between revenues and expenditures while safeguarding public investment and social protection spending.

9. Public debt management has improved significantly with a more diversified maturity profile for T-bond issuances to allow for more active cash management and facilitate money market development. The authorities agree with staff's advice that more active cash management would help minimize net borrowing costs by avoiding unnecessary idle cash balances. Cash balance of around 9 percent of GDP as stated in the staff report includes not only cash balance of State Treasury but also the extra-budget funds (equitization, cumulative sinking fund etc.) and financial reserves of provincial government, which are required by law to be held at the Treasury. The authorities fully recognize the benefit of sweeping cash resources at the SOCBs into the State Treasury's single account at the SBV to consolidate and manage government's cash resources, thus minimizing its borrowing costs. Therefore, the authorities are considering Fund TA advice together with alternative models and approaches for designing a TSA that takes into account country specificities as well as preconditions and desirable sequencing for its successful implementation.

Monetary and exchange rate policy

10. In 2018, credit growth has declined to below 14 percent, lower than the SBV's 17 percent ceiling. Credit growth is expected to decelerate further in 2019. The authorities believe this is appropriate from both perspectives of monetary and financial stability since it helps contain excessive foreign exchange movements and close the credit gap while remaining supportive of growth objectives. Administrative allocation of credit will be retained for an extended period of time. When all banks are able to adopt Basel II standards and supervisory and regulatory preconditions are met, further relaxation or gradual phasing out of credit ceilings can be considered in order to move to a monetary policy framework based on indirect instruments.

11. The authorities welcome staff's view that the SBV has skillfully maintained orderly market conditions while ensuring ample liquidity amidst heightened volatility in 2018. During the year, the SBV allowed for greater two-way exchange rate flexibility within the current band to absorb shocks, including from volatile capital flows. The gradual reserve accumulation continued, as conditions allowed, with fully sterilized interventions. As a result, the depreciation has been less than those seen in some other emerging markets, only 2.2 percent against the U.S. dollar. The authorities remain strongly committed to having a flexible exchange rate as a primary shock absorber and reiterate that market intervention was never intended to resist trend appreciation. However, as a small and highly open economy, external developments will continue to affect investment behavior, and periods of heightened capital flows and exchange rate volatility are inevitable. The authorities believe that prolonged periods of excessive exchange rate volatility could disrupt orderly financial market activity and eventually spill over to the real economy. Therefore, the authorities' key consideration is to ensure that levels of volatility are not excessive to preserve orderly market conditions, maintain public confidence and promote overall financial stability.

12. On the external balance assessment, the authorities observed that the different approaches yield opposite results. Moreover, authorities reiterate that the large current account surplus in recent years is attributed to Vietnam's structural factors which could not be fully explained by the EBA-lite model. As the structural adjustment takes time to materialize, the authorities emphasize that external rebalancing should not be borne solely by an exchange rate adjustment. A well-designed and appropriate mix of policies and measures should be pursued flexibly in line with changing economic circumstances specific to the country to achieve not only external rebalancing but also economic and financial stability. The current account surplus has been adjusting in the right direction and will continue to decline over the medium term. It is noted that the ongoing public investment and number of structural reforms would help strengthen domestic demand and moderate the current account surplus going forward.

Financial sector

13. The banking sector's performance has improved significantly in recent years and bank recapitalization is on track. The authorities agree with staff that bank earnings have risen in response to a shift to retail lending and consumer finance. The share of non-interest incomes related to corporate bond issuance, credit card, and cash transfer has increased and contributed to profitability. As large firms issue more corporate bonds, banks have increased credit to SMEs recently, thus improving SMEs' access to credit. Fintech helps banks to expand their customer base while fostering financial inclusion.

14. The resolution of legacy loans was also significantly stepped up, aided by the strong economy. NPL ratios have been declining and banks have aggressively resolved NPLs with the Vietnam Asset Management Corporation (VAMC). The SBV coordinated with institutions and the VAMC in aggresively implementing solutions stipulated in the 2016 – 2020 Masterplan of Restructuring of Credit Institution System and the National Assembly's Resolution No 42 on Piloting NPL Resolution, ensuring that the implementation is on track and in line with NPL resolution's and control's objectives, roadmap and plan, while preventing risks to the banking system's stability.

15. Strengthening bank capital is a top priority. As the January 1, 2020, deadline for implementing Basel II rules, approaches, the authorities formulated a bank-by-bank strategy for recapitalizing large state-owned commercial banks (SOCBs), using private money where possible and allowing SOCBs to retain earnings and equitization proceeds as needed. The authorities are fully aware that while there is progress in NPL resolution, NPL ratios remain high and there is a risk that it could be interrupted by a downturn in the economy. Bank balance sheets are still vulnerable to shocks and could be a risk to macroeconomic stability. Therefore, the authorities consider bank recapitalization, especially for SOCBs, a top priority and should be accelerated.

16. The authorities are of the view that vulnerabilities in the non-banking sector, if not properly contained, could have adverse impact on economic and financial stability. As rightly pointed out by staff, the authorities agree that there should be greater coordination and cooperation among key financial regulators in jointly addressing the

bouts of volatility. Therefore, the authorities intend to form a multi-agency financial stability committee chaired by a Deputy Prime Minister to discuss system-wide risks and policy measures on a regular basis. The SBV is making substantial progress in improving its Financial Stability Report, and will consider to disseminate its main conclusions across key agencies so that it could better inform policy decisions. Going forward, the authorities will remain vigilant to changes in the financial landscape from Fintech developments and potential challenges arising from cybersecurity issues.

Structural Reforms

17. The authorities consider reform and modernization of macroeconomic frameworks and institutions a key priority. The Vietnamese government is committed to private sector- led growth and has shifted to a model that emphasizes the state's enabling function over public production. Regulatory quality and ease of doing business have improved. The legal framework for SOEs was revamped with the creation of an independent State Capital Management Committee (SCMC) to oversee all large SOEs to improve accountability and efficiency, while leaving management and regulation with line ministries and regulatory bodies.

18. Moving forward, the authorities will focus on modernizing institutions of macroeconomic management, strengthening the supervision and management of the banking sector and SOEs and allowing 100 percent foreign ownership in areas not critical to national security; modernizing regulation, reducing the concentration of land in state hands, and strengthening data provision and dissemination.

Governance and AML/CFT

19. The authorities are strengthening its governance and anti-corruption efforts. The 2018 anti corruption law strengthens the system for assets declaration and is in line with best practices to enhance its effectiveness. Additional reform priorities for the future include greater fiscal transparency and stronger public investment management.

20. The authorities have conducted the National Risk Assessment (Assessment) on money laundering and terrorism financing for 2012 – 2017 period. The Assessment has identified the overall ML risk of the country as "higher medium" and the overall FT risk as "low". Based on the Assessment, the authorities have issued Decision No. 474/QD-TTg dated April 30, 2019 adopting the National Action Plan (Plan) to address deficiencies and risks associated with AML/CFT framework for the period of 2019-2020 as identified in the Assessment. The Plan aims at strengthening the effectiveness of AML/CFT regime in Vietnam, addressing any related risks and deficiencies identified in the National Risk Assessment, adopting FATF standards, and preparing for the upcoming APG assessment. The Plan also includes outreach activities on AML issues, training and regulatory capacity building, as well as closing regulatory gaps by November 2019.

Conclusion

21. The authorities will continue to implement their reform agenda to help realize the

country's full growth potential. However, the authorities are also mindful of the considerable challenges that lie ahead and realize that sustainable results would take time to materialize. The authorities are fully committed and determined towards steadfast implemention of necessary structural reforms and policies that will continue to improve the investment climate and sustain economic growth, while providing buffers against external and domestic shocks. Growth will be made more inclusive and made more resilient with continued focus on fiscal prudence, well-grounded monetary management and financial stability, improved competitiveness of SOEs, and sound banking system. The depth of these reforms and the pace of their implementation would be appropriately calibrated to achieve the desired outcomes while minimizing unintended consequences.

22. Finally, the authorities are cognizant that these efforts need to be supplemented by support from multilateral institutions and other countries. In this light, our Vietnamese authorities would like to express their appreciation to the Fund in providing policy advice and invaluable technical support, and look forward to continued cooperation in the years to come.