



# AMRO Annual Consultation Report

## Vietnam - 2020

ASEAN+3 Macroeconomic Research Office (AMRO)

May 2021

## Acknowledgments

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1. This Annual Consultation Report on Vietnam has been prepared in accordance with the functions of AMRO to monitor, assess and report its members' macroeconomic status and financial soundness, to identify relevant risks and vulnerabilities, and to assist them in the timely formulation of policy to mitigate such risks (Article 3 (a) and (b) of the AMRO Agreement).
2. This Report is drafted on the basis of the Annual Consultation of AMRO on Vietnam in December 2020 and January 2021 (Article 5 (b) of AMRO Agreement). The AMRO Mission team was headed by Dr Seung Hyun Luke Hong, Group Head and Lead Specialist. Members include Dr Jade Vichyanond, Desk Economist on Vietnam; Dr Nguyen Thi Kim Cuc, Senior Economist; Dr Jinho Choi, Senior Economist; Ms Marthe Memoracion Hinojales, Economist; Mr Nguyen Thang Long, Associate; and Mr Hoang Viet Phuong, Associate. AMRO Director Mr Toshinori Doi and Chief Economist Dr Hoe Ee Khor also participated in key policy meetings with the authorities. This AMRO Annual Consultation Report on Vietnam for 2020 was peer reviewed by Dr Lee Jae Young, Group Head and Lead Economist, and Dr Zhiwen Jiao, Economist, and approved by Dr Hoe Ee Khor, AMRO Chief Economist.
3. The analysis in this Report is based on information available up to 11 February 2021.
4. By making any designation of or reference to a particular territory or geographical area, or by using the term "member" or "country" in this Report, AMRO does not intend to make any judgments as to the legal or other status of any territory or area.
5. On behalf of AMRO, the Mission team wishes to thank the Vietnamese authorities for their comments on this Report, as well as their excellent meeting arrangements and hospitality during our visit.

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## Executive Summary

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**1. Vietnam's economy has been resilient against the COVID-19 pandemic.** After a sharp decline in GDP growth in Q2, the economy rebounded in Q3 and Q4, registering 2.9 percent growth on an annual basis in 2020. The economic recovery was broad-based and was enabled by the effective containment measures against the pandemic. Manufacturing output was boosted by the robust export sector, which benefited from Vietnam's relatively resilient export mix as well as positive spillover from global supply chain restructuring. While domestic consumption recovered following the relaxation of mobility restrictions, the growth rebound benefited also from an acceleration in public investment disbursement. The economy is expected to continue to rebound in 2021, to around 7 percent growth on an annual basis on the back of a strong recovery in external demand, a resilient domestic economy and continued investment inflows.

**2. The external position continued to strengthen, reflecting the higher current account surplus and continued capital inflows.** Despite a relatively subdued export performance in textile and garments, continued demand for Vietnam's exports of electronics, as well as for furniture and wood products, has helped the export sector's robust recovery and led to an increase in the current account surplus. Meanwhile, capital inflows were supported by strong inflows of foreign direct investment which more than offset outflows in other investments. As a result, the balance of payments registered a substantial surplus, contributing to a further accumulation of foreign reserves, while the VND exchange rate was relatively stable against USD in 2020.

**3. The decline in economic growth and fiscal stimulus measures led to a widening of the budget deficit in 2020.** On the revenue side, strengthened tax administration helped partially offset the negative impact of lower economic growth and fiscal stimulus measures. Meanwhile, the government's total expenditure was above target in light of pandemic support measures and higher public investment spending. Consequently, the 2020 fiscal deficit increased to 3.4 percent of GDP from the original budget target of 2.9 percent of GDP and actual outturn of 2.6 percent of GDP in 2019.

**4. The SBV eased monetary policy and took macroprudential and regulatory measures to support bank lending to the private sector.** The SBV has cut key policy rates by a total of 150-200 basis points since the start of 2020. The SBV also delayed the phased reduction of the ratio of short-term funding to medium- to long-term loans by one year. The easing stance in both monetary and macroprudential policy has left the banking system flush with liquidity, supporting credit growth. Furthermore, the SBV issued guidelines for commercial banks to reschedule loan repayments and reduce or waive interest and fees of borrowers, in addition to providing regulatory forbearance to banks with respect to loan classification.

**5. Key external and domestic risks stem mainly from the uncertainty over the impact of the pandemic and its evolution.** A protracted and uneven recovery of the global economy may jeopardize the recovery in external demand. In addition, supply chain disruptions due to renewed border closures and ongoing U.S.-China trade tensions may pose an obstacle to recovery from the supply side. While domestic demand is picking up after a relatively successful containment of the pandemic, the recovery remains susceptible to

the risk of further waves of COVID-19 infection. Moreover, lasting scars from the pandemic, such as the corporate sector's financial distress and the pandemic's impact on labor and employment, may undermine the strength of economic recovery in the period ahead.

**6. Risks in the financial sector may arise from the impact of COVID-19 pandemic measures on asset quality and trends in banks' loan portfolios.** Despite banks' efforts on loan restructuring, it is likely that the banks' asset quality will further deteriorate and erode their relatively thin capital buffers. Furthermore, the SBV's forbearance policy on loan classification has made it difficult to ascertain the true extent of the deterioration in asset quality and, thus, more challenging to accurately assess banking system soundness.

**7. The U.S. allegation of currency manipulation could lead to imposition of some trade measures on Vietnam's exports to the U.S.** Potential actions by the U.S. for the most part may include measures to reduce the trade surplus with the U.S., such as tariff increases on the exports of certain Vietnamese products, agreements to purchase U.S. imports, and limits on access to U.S. development financing.

**8. With continuing uncertainty over the growth prospects, fiscal policy should continue to support the economy.** In light of available fiscal space and with economic recovery still subject to heightened uncertainty, greater fiscal support may be warranted to support the nascent economic recovery, while targeted support to MSMEs and low-income households should be continued and be regularly reviewed for its relevance and effectiveness. Furthermore, the enhancement of support programs through simpler and better-targeted disbursement will help facilitate the effective use of government funds. In addition, it is important to ensure the continued implementation of the public investment program.

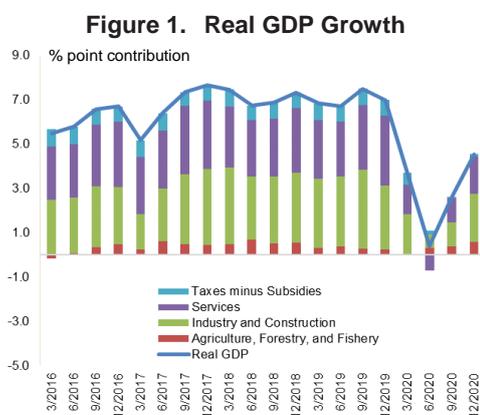
**9. The easing of monetary and macroprudential settings has been appropriately supportive of the economy.** On the monetary policy front, the rate cuts were welcome moves, which have lowered banks' financing costs. The forthcoming expansion in the coverage of debt rescheduling is welcome to ease the pressure on affected borrowers during the economic recovery. Going forward, given the benign inflation outlook, monetary policy should remain supportive of economic recovery. Asset price and leverage conditions need to be closely monitored and taken into consideration in determining when and how the policies should be adjusted.

**10. Structural reforms should be accelerated to bolster economic recovery and ensure a sustainable development path.** With SOE equitization slowing in recent years, resolving structural obstacles is critical to improving productivity and enhancing growth potential. Further efforts to develop and upgrade domestic supporting industries are increasingly needed in order to strengthen the country's participation and domestic value added in the global value chains. As far as human capital is concerned, improvement in tertiary education and greater emphasis on technical and vocational programs are some of the key priorities in the country's effort to boost labor productivity. Lastly, it is essential to ensure continued support for long-term development issues while carefully managing risks to long-term fiscal sustainability.

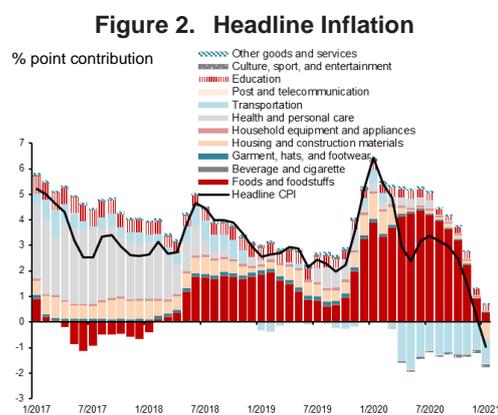
## A. Recent Developments and Outlook

### A.1 The economy is resilient against the Covid-19 pandemic

**1. The economy slowed sharply to 2.9 percent growth in 2020 but is expected to rebound strongly by 7 percent in 2021.** After a sharp decline in GDP growth in Q2, the economy started to rebound in Q3, facilitated by the effectiveness of the containment measures (Figure 1). The economic recovery was relatively broad-based. Manufacturing activity was boosted by the robust export sector, which benefited from Vietnam’s relatively resilient export mix as well as positive spillover from global supply chain restructuring. Meanwhile, the service sector rebounded as domestic consumption recovered following the relaxation of mobility restrictions, a result of the authorities’ effective COVID-19 containment efforts. Furthermore, the growth rebound benefited from an acceleration in public investment disbursement. From the demand perspective, exports and investment were the main drivers of growth in 2020. By and large, employment in export-oriented sectors, except textile and apparel, has experienced better recovery than most other sectors. Growth is expected to continue to rebound in 2021, registering around 7 percent on an annual basis on the back of a strong recovery in external demand, a resilient domestic economy, and continued investment inflows (Selected Issue: Vietnam’s Strong FDI as a Driver of Economic Growth). The tourism sector will likely remain anemic in 2021, with cross-border travel restrictions still in place in most countries—including Vietnam—for most of the year due to the slow roll-out of the vaccines and the risk of renewed waves of COVID-19 infection.



Source: General Statistics Office; CEIC; AMRO staff calculations

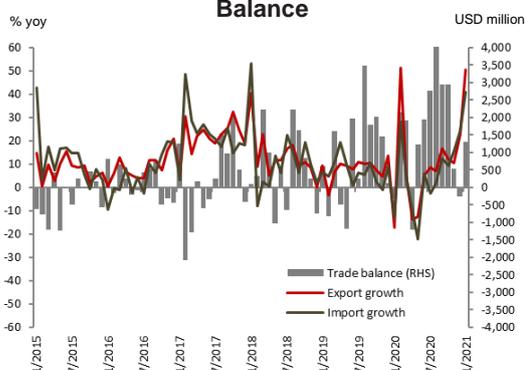


Source: General Statistics Office; CEIC; AMRO staff calculations

**2. Moderation in food prices and subdued transport costs helped to dampen headline inflation in 2020.** High food prices—particularly of pork—were chiefly responsible for the uptick in inflation in early 2020 (Figure 2). However, effective food supply management, increased imports of live pigs, and effective containment of the swine flu helped bring down food inflation later in the year. Moreover, the decline in energy prices pulled down transport and housing costs, allowing the authorities to contain inflation, which averaged 3.2 percent in 2020, within the 4-percent target ceiling, while core inflation continued to trend down, reflecting a combination of weaker demand and some transmission from food prices. Headline inflation is expected to be contained within the 4-percent target in 2021 to the extent that the country’s food supply is well-managed, energy prices remain relatively stable, and upward adjustments in administered prices, if any, are moderate.

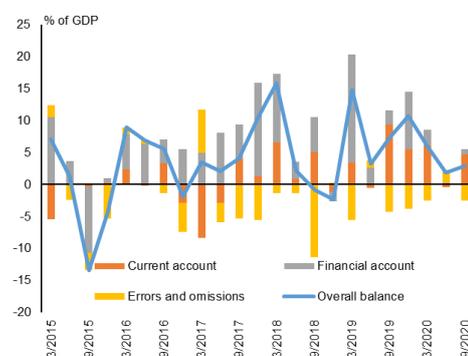
**3. The external position continued to strengthen, reflecting a widening of the current account surplus and continuing capital inflows.** Despite a relatively subdued export performance in a number of sectors, in particular textile and garment, continued demand for Vietnam’s exports of electronics, as well as for furniture and wood products, has helped the export sector recover, contributing to a high trade surplus (Figure 3). Meanwhile, FDI inflows remained strong although overall capital inflows were dragged down by a decline in portfolio investment and other investment amid an uncertain global environment (Box A). Reflecting the strong performance, the balance of payments registered a large surplus, contributing to a further accumulation of foreign reserves—which stood at around \$92 billion as of September 2020—while the VND exchange rate was relatively stable against USD in 2020 (Figure 4). Looking ahead, Vietnam’s expanding number of free trade agreements (FTAs) should help sustain exports, especially in the textile and garment, furniture and wood products, and fishery sectors.<sup>1</sup>

**Figure 3. Export and Import Growth, Trade Balance**



Source: General Statistics Office; CEIC; AMRO staff calculations

**Figure 4. Balance of Payments**



Source: General Statistics Office; CEIC; AMRO staff calculations

**Box A. Push and Pull Factors for Vietnam’s FDI<sup>2</sup>**

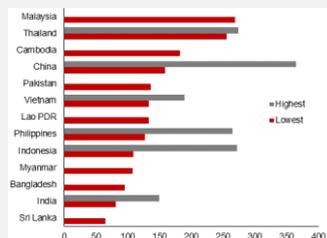
**A number of push and pull factors underlay the FDI patterns that have played out in Vietnam.** Over the past few decades, Vietnam has benefited significantly from favorable external conditions, or push factors, as well as Vietnam’s attractive domestic conditions, or pull factors.

**One of the main push factors for the influx of FDI has been rising wages in China and other regional economies.** China’s ascent during 2000s to become the world’s preeminent manufacturing hub was enabled by a number of policy measures as well as macroeconomic conditions, with relatively low wages being one of the key facilitating conditions. However, as the country’s income level increased, so did wages, which eroded the cost competitiveness of some manufacturers located in China and spurred many to relocate to countries with lower labor costs (Figure A1). Similarly, as income levels in other regional countries such as Thailand and Indonesia increased, labor-intensive industries in those countries found it advantageous to look for locations with lower wages.

<sup>1</sup> The country’s participation in the FTAs is particularly vital in the context of reconfiguration of global supply chains, whereby Vietnam competes with countries of similar levels of development in attracting foreign investment.

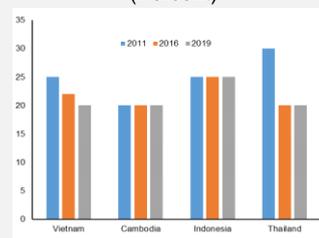
<sup>2</sup> This box was prepared by Marthe Memoracion Hinojales and Jade Vichyanond.

**Figure A1. Minimum Wages, 2019**  
(US Dollars Per Month)



Source: Cambodia's Ministry of Labor; Vocational Training and AMRO staff calculations

**Figure A2. Corporate Income Tax Rates in Vietnam and Selected Regional Countries**  
(Percent)



Source: KPMG; AMRO staff calculations

**Against this backdrop, Vietnam's attractive labor costs and relatively skilled workforce constitute one of the major draws for foreign investors.** Thanks to a favorable demographic profile, with almost 60 percent of the population under 35 years of age, the relatively abundant supply of labor has allowed Vietnam's wages to remain competitive, especially compared to other regional countries. Moreover, the country's continued emphasis on education investment has increased the supply of relatively skilled labor, pulling in FDI in industries that increasingly demand technological know-how, such as the electrical and electronics industry.

**U.S.-China trade tensions and the associated global supply chain restructuring have helped accelerate the flow of FDI into Vietnam.** Since the U.S. began imposing tariffs and other trade barriers on China in 2018, a number of multinational firms in China have announced or begun plans for relocating some of their production facilities, if not all, to other countries to maintain cost-competitiveness. They often look for a place not far from China, enabling convenient transport of Chinese raw materials and intermediate input for further processing and assembly. One of these examples is Apple, which is shifting nearly 30 percent of its wireless headphone production from China to Vietnam.<sup>3</sup>

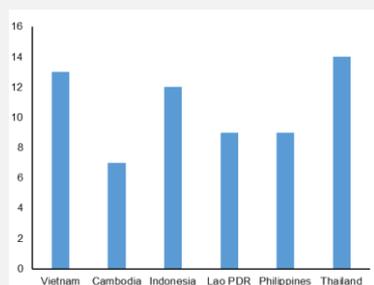
**Comprehensive policy efforts by the Vietnamese government have created a favorable environment for foreign investors.** Understanding FDI's contribution to economic development, the Vietnamese authorities implement a wide range of measures to improve business environment and place great emphasis on investment facilitation for foreign companies, especially large ones. Assistance is provided in various areas, ranging from land acquisition and registration to export and import licensing procedures. Additionally, reduction in corporate income tax rates over the past several years (the current rate is 20 percent) and generous tax breaks—such as for companies investing in high-tech sectors, certain industrial zones, and underdeveloped socio-economic regions—help ensure cost-competitiveness for foreign companies operating in Vietnam (Figure A2).

**Moreover, Vietnam's proximity to key regional markets and fast expanding FTAs have proven beneficial in attracting FDI.** With China as a northern neighbor, Vietnam possesses easy access to one of the world's largest consumer markets as well as one of the world's major suppliers of intermediate inputs. The country is also well connected to Japan and Korea, which are increasingly outsourcing parts of their supply chains to Vietnam, taking advantage of proximity and convenient shipping routes off Vietnam's extensive shoreline on the South China

<sup>3</sup> Other examples include Google's production of motherboards (to Taiwan Province of China); some production of Foxconn, Apple's main assembler, and its subsidiary Sharp; laptop maker Inventec Corp; Quanta Computers' production of computer servers (to Taiwan Province of China); mobile electronics maker Zebra Technologies; tracker and smartwatch maker Fitbit; auto parts manufacturer Hyundai Mobis (to Korea); toymaker Hasbro; Sony's production of smartphones; Samsung Electronics personal computer and mobile telephone production (to Thailand); camera maker GoPro; some production of Intel; and some console production of Nintendo. Those without destination economies mean that the company has relocated to, or planning to relocate, in several economies; or in some cases, unannounced.

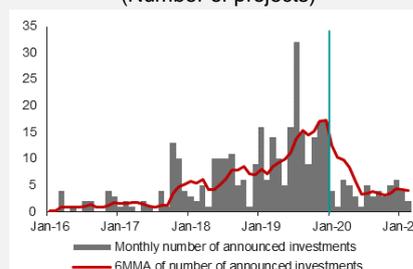
Sea. In addition to Vietnam's geography, its own initiatives to expand the market through FTAs, particularly with countries and regional blocs with large market potential, have made the country more competitive as a production hub (Figure A3).<sup>4</sup>

**Figure A3. Number of FTAs Signed and in Effect, 2020**



Source: ADB Asia Regional Integration Center; AMRO staff calculations

**Figure A4. Monthly Announcements of Investment Plans Directed towards Vietnam (Number of projects)**



Source: Orbis CrossBorder Investment database; AMRO staff calculations

**More recently, the COVID-19 outbreak has presented Vietnam with an additional push factor.** As border control measures were imposed in order to limit the contagion, a large number of firms whose production relied on imported intermediate input were suddenly cut off from their supply network and hence unable to continue operating. Moreover, with tightened border controls, many firms with high dependence on certain countries as final sources of demand experienced difficulty in exporting to those countries. These trade bottlenecks thus served as a further impetus for firms to diversify their production base, with Vietnam as one of the most promising countries to which to co-locate/ relocate production.<sup>5</sup> While the COVID-19 pandemic has somewhat stymied future investor plans (Figure A4), actual FDI inflows appear to have weathered the pandemic strongly, underscoring Vietnam's continuing ability to pull in investment.

## A.2 Strong policy supports recovery

**4. Expansionary fiscal policy helped support the economy amid the COVID-19 pandemic (Table 1).** On the revenue side, strengthened tax administration helped partially offset the negative impact of lower economic growth and fiscal stimulus measures (including the lowering of corporate income tax rates for small businesses, reduction in various fees, among others), allowing revenue collection to reach 98 percent of the target.<sup>6</sup> Meanwhile, the government's total expenditure reached 102 percent of the target, on the back of pandemic support measures and higher public investment spending. Consequently, the 2020 fiscal deficit increased to 3.4 percent of GDP, from the original budget target of 2.9 percent of GDP and up from 2.6 percent of GDP in 2019 (Figure 5). Public debt increased slightly from 43.4 percent of GDP as of end-2019, to around 43.6 percent of GDP by the end of 2020.<sup>7</sup> As for 2021, the budget projects a

<sup>4</sup> In January 2019, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), came into force, and in August 2020, the EU-Vietnam Free Trade Agreement (EVFTA) became effective. More recently, Vietnam joined the Regional Comprehensive Economic Partnership (RCEP) in November 2020.

<sup>5</sup> In 2019, nearly USD 710 million co-location plans were announced, from only USD 76 billion in 2017. Vietnam also benefits from relocated FDI – a major example is the USD 70-billion move of LG Electronics, when it shifted its smartphone manufacturing plant from Korea to Vietnam in 2019.

<sup>6</sup> The strengthening in tax administration involved enhanced fraud detection, more comprehensive auditing, and greater containment of tax arrears.

<sup>7</sup> The figures are calculated based on AMRO's estimates for the new nominal GDP series. Under the old GDP series, the 2020 fiscal deficit and public debt stood at 3.9 percent and 55.3 percent of GDP, respectively.

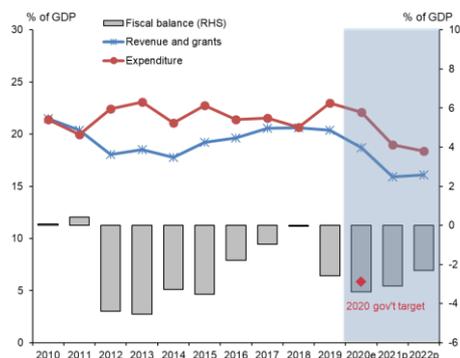
conservative level of revenue collection and a relatively flat expenditure outlay compared to 2020 outturn, with the fiscal deficit targeted at 3.9 percent of GDP.

**Table 1. Selected Fiscal Policy Responses in 2020**

Areas	Specific measures
Tax deferment, reduction, and exemption	(i) Tax exemptions for the import of medical equipment used for the fight against Covid-19 (ii) Deferment of VAT and CIT payment and land rental fees by 5 months until the end of 2020, deferring PIT payment to year-end (iii) Reduction in car registration tax by 50 percent and deferring excise tax on domestically produced cars until year-end (iv) CIT rate cut by 30 percent for the 2020 tax calculation year (v) Reduction of the environmental protection tax on jet fuel by 30 percent until year-end
Reduction in fees and charges	(i) Reduction or exemption of various fees and charges (e.g. business registration fee, securities market transaction fee) (ii) Lowering of land rental fee by 15 percent for 2020
Labor market support	(i) Deferment of firms' and workers' contributions to the pension fund and the survivorship fund without interest penalty for up to 3 months (ii) Monthly cash transfer package for affected workers and households for no more than 3 months
Other	(i) Reduction of electricity tariff for households and businesses by 10 percent and for medical centers, hospital, and quarantined facilities by 20 percent. (ii) Reduction of loan interest rates of the Small and Medium Enterprise Development Fund by 2 percentage points for eligible SMEs.

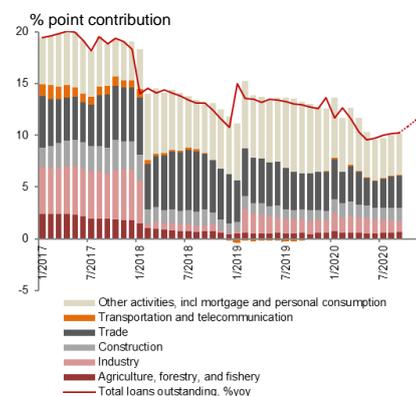
Sources: AMRO staff compilation

**Figure 5. Fiscal Revenue and Expenditure, Fiscal Balance**



Source: GSO; CEIC; AMRO staff calculations

**Figure 6. Credit Growth**



Source: GSO; CEIC; AMRO staff calculations

**5. The SBV eased monetary policy and took macroprudential and regulatory measures to support bank lending to the private sector. (Table 2).** To support lending growth and ease financial pressure on banks and borrowers, the SBV cut key policy rates three times, by a total of 150-200 basis points, since the start of 2020. The SBV also delayed the phased reduction of the ratio of short-term funding to medium- to long-term loans by one year. The easing stance in both monetary and macroprudential policy has left the banking system flush with liquidity, supporting credit growth, which registered 12.1 percent (yoy) as of end-2020 compared to 13.6 percent as of end-2019 (Figure 6). Furthermore, the SBV issued guidelines for commercial banks to reschedule

loan repayments and reduce or waive interest and fees of borrowers, in addition to providing regulatory forbearance to banks with respect to loan classification.<sup>8</sup>

**Table 2. Selected Monetary and Macroprudential Policy Responses in 2020**

Areas	Specific measures
Lowering policy rates	The SBV lowered its key policy rates three times in 2020. (i) March: Cut the key policy rates by 50-100 bps (100bps for the refinance rate and 50bps for the discount rate) and the repurchase rate by 50bps (ii) May: Cut the key policy rates and the repurchase rate by 50 bps (iii) October: Cut the policy rates and the repurchase rate by 50 bps. The short-term deposit rate cap was cut by 25 bps, and the short-term lending rate cap for priority sectors was reduced by 50 bps.
Regulatory Forbearance	The SBV instructed banks to restructure loans disbursed prior to 23 January 2020 that have been affected by the pandemic. (i) Loan rescheduling/ restructuring: the repayment of loan principal and interest could be extended by not more than 12 months from the original due date (ii) Interest and fee lowering/ exemptions (iii) Loan classification of restructured loans will be kept unchanged.
Delay in macroprudential tightening	The phased reduction of the ratio of short-term funding to finance long term loans was delayed by one year, to help credit institutions reduce their cost of funding and maintain medium- and long-term loans outstanding. <sup>9</sup>
Other	(i) The SBV encouraged credit institutions to channel credit to five priority economic sectors and sectors that are engines of economic growth. (ii) The SBV provided a credit line to the Vietnam Bank for Social Policies (VSPB) at zero percent interest rate. Affected firms are eligible for concessional loans from VSPB with no interest for making salary payment to their workers who temporarily stopped working. (iii) The SBV instructed credit institutions to actively reduce bonus and salary, cut other operating costs, adjust business plans (including not paying dividend in cash), and use the saved resources to reduce interest. (iv) The interest rate on banks' compulsory reserves was halved to 0.5 percent per annum. The interest rate on deposits by the Vietnam State Treasury, the Deposit Insurance of Vietnam, and several other financial institutions, was also lowered by 0.2 percentage point to 0.8 percent. (v) Interbank transaction costs were cut by 50 percent, to remain until 31 December 2020.

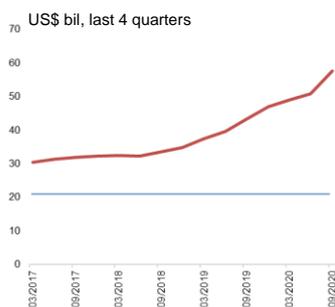
Sources: AMRO staff compilation

**6. After being included on the U.S. watchlist for currency manipulation in 2019, Vietnam was labelled a currency manipulator by the U.S. Treasury at the end of 2020.** The decision was based on Vietnam meeting all three criteria used by the U.S. Treasury to assess whether a given country is a currency manipulator: bilateral trade surplus with the U.S. of more than USD20 billion, current account surplus of more than 2 percent of GDP, and foreign exchange intervention of more than 2 percent of GDP over the past year (Figures 7 to 9 and Box B). In response, the Vietnamese authorities have made efforts to increase imports from the U.S., in particular of automobiles, GMO products, and meat and poultry, with a view to reducing the bilateral trade surplus, and are currently in discussions with the U.S. government on how to resolve the issue.

<sup>8</sup> Under this guideline, about 4 percent of the banking system's loans were rescheduled as of mid-September and about 28.6 percent of total outstanding loans were allowed lower interest payments as of mid-July.

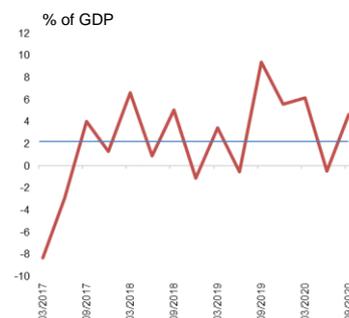
<sup>9</sup> According to SBV Circular 08/2020 dated August 2020, banks can keep their ratio of short-term funding to loans with maturities of 12 months and above at 40 percent until 30 September 2021, and then gradually lower it to 37 percent by September 2022, to 34 percent by September 2023, and finally to 30 percent by 1 October 2023.

**Figure 7. Bilateral Trade Surplus with the US**



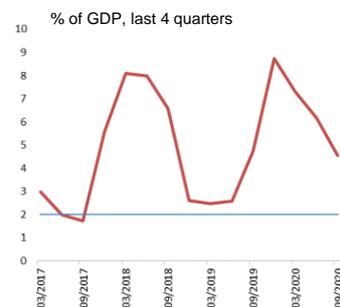
Source: GSO; CEIC; AMRO staff calculations

**Figure 8. Current Account**



Source: GSO; CEIC; AMRO staff calculations

**Figure 9. Change in Foreign Reserves**



Source: GSO; CEIC; AMRO staff calculations

**Box B: Vietnam's Foreign Exchange Regime and Capital Flow Regulations<sup>10</sup>**

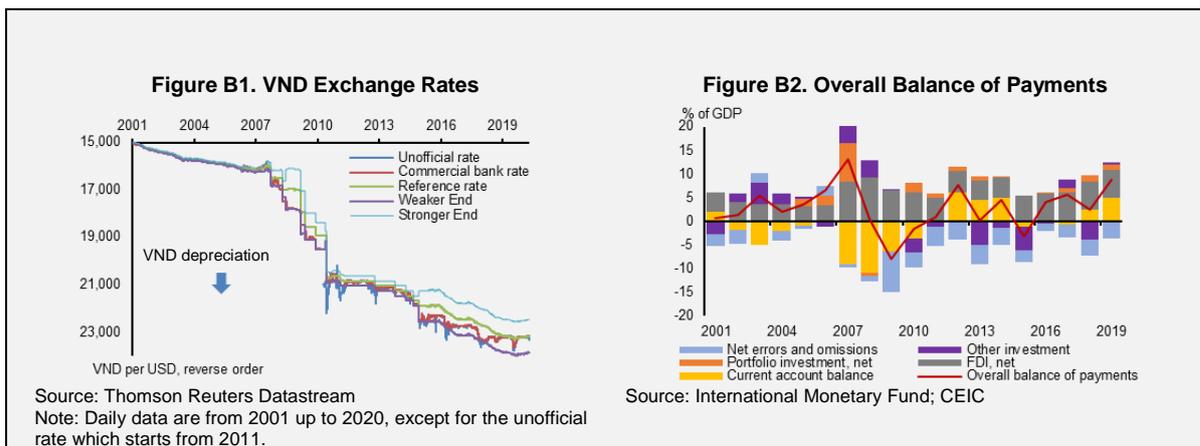
The Vietnamese *dong* has been trading against the U.S. dollar within a band around a reference rate set by the SBV. The reference rate is set based on (i) the weighted average interbank exchange rate; (ii) currency movements in Vietnam's key trade, investment, lending and borrowing partners; and (iii) macroeconomic and monetary balances and monetary policy objectives. Besides the interbank market, there is a foreign exchange market between banks and their customers – that is, firms and individuals, where the exchange rate is allowed to move within the trading band.<sup>11</sup>

The foreign exchange regime has been made more flexible with a daily-adjusted reference rate and wider trading band since 2016. Until 2006, the SBV set the reference rate on a daily basis with the trading band at  $\pm 0.75$  percent, widened somewhat from  $\pm 0.1$  percent in 2001 (Figure B1). After its WTO accession in 2007, Vietnam saw an increase in (non-FDI) capital inflows, which helped finance an enlarged current account deficit. Those flows, nevertheless, reversed during the GFC, which, coupled with domestic hoarding of foreign exchanges, led to BOP deficits and a drain on foreign reserves in 2009-10 (Figure B2). The SBV devalued the reference rate by a cumulative 10 percent and widened the trading band to  $\pm 5$  percent during the same period. Following another devaluation of 9 percent in early 2011, the *dong* was tightly pegged against the U.S. dollar between 2011 and 2015, with only one or two adjustments made to the reference rate each year, and the trading band narrowed to  $\pm 1$  percent until August 2015. That said, downward pressures on the *dong* had built up, most notably during 2014-2015 when the U.S. dollar strengthened against emerging market currencies. In addition to more frequent adjustments to the reference rate, the SBV re-widened the trading band to  $\pm 3$  percent in 2015. Further reforms to the foreign exchange regime were adopted in early 2016 with the re-introduction of daily adjustment to the reference rate in line with the previous day's *dong* exchange rate in the interbank market, the movement of a basket of currencies belonging to Vietnam's major trading partners and creditors, as well as domestic macroeconomic developments.<sup>12</sup>

<sup>10</sup> This box is prepared by Nguyen Thi Kim Cuc and Hoang Viet Phuong, with inputs from Jade Vichyanond and Nguyen Thang Long.

<sup>11</sup> For more information about the official foreign exchange market structure and participants in Vietnam, one could refer to the latest **combined legal documents** regulating the foreign exchange market in Vietnam, including the Ordinance on Foreign Exchange Management in 2005 and amendments in 2013.

<sup>12</sup> SBV Decision 2730 dated 31 December 2015, effective 2 January 2016.



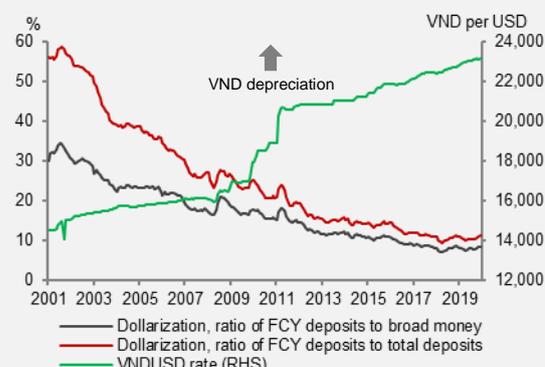
**Measures have been taken concurrently to contain dollarization.** The authorities have gradually phased out the mobilization of deposits and lending in foreign currencies. In particular, to disincentivize individuals and firms from holding foreign currencies, a cap on U.S. dollar deposit interest rates was introduced in 2011, and that was subsequently lowered to zero percent in 2016.<sup>13</sup> FCY loans have been restricted to borrowers generating revenues in foreign currencies (Table B1).<sup>14</sup> Additionally, banks' net open position in foreign exchange to capital ratio has been capped at 20 percent since 2012 to reduce banks' exposure to currency mismatch, down from 30 percent.<sup>15</sup> Administrative measures have been deployed to enforce the limited use of foreign currencies in the domestic market in line with Ordinance on Foreign Exchange Management 2005 and its amendments in 2013. Dollarization, reflected in the share of FCY deposits in total deposits and in broad money, has declined and has stabilized at a relatively low level for the past few years (Figure B3).

**Table B1. Selected De-Dollarization Measures since 2011**

- Implemented a roadmap to phase out/ eliminate banks' FCY lending and deposit mobilization by 2020
  - Lowered FCY deposit rate gradually to zero percent from 2016 onwards
  - Restricted FCY lending only to borrowers who can generate revenues in foreign currencies
- Increased in reserve requirement ratio for FCY deposits
- Strengthened enforcements on the unofficial forex markets
- Strengthened declaration of USD cash amounts at customs
- Regulated individual's purchase of foreign currencies
- Enhanced communications with market participants about the foreign exchange rate management policy

Source: AMRO staff compilation

**Figure B3. Dollarization versus VND Exchange Rate**



Source: State Bank of Vietnam; CEIC; AMRO staff calculations

**Regulations related to capital inflows have been relaxed relative to controls on outflows.** The Government has actively pursued policies to attract inward direct investment, or FDIs, since as early as the 1990s.<sup>16</sup> Meanwhile, restrictions on portfolio investment inflows—including the 49-percent cap on foreign ownership of public companies—have been relaxed more recently.<sup>17</sup> This, together with a

<sup>13</sup> SBV Decision 2589 dated December 2015.

<sup>14</sup> SBV's combined legal document 06/VBHN dated January 2019.

<sup>15</sup> SBV's Circular 7 in 2012.

<sup>16</sup> The Foreign Direct Investment Laws in 1987 and 1996 opened the domestic economy to foreign investors on relatively liberal terms, and offered generous incentives, including tax incentives, to FDI projects. No restrictions have been imposed in terms of FDI-related capital flow movement, such as profit repatriation. Those incentives remain in the unified Investment Law launched in 2005, which was subsequently replaced by the Investment Law in 2014 and 2020.

<sup>17</sup> According to Government Decree 60 in 2015, there is no limit on foreign ownership among public firms, except for those in conditional sectors that are subject to a specific (lower) foreign ownership limit (such as banking and finance, or companies with State capital/investment).

recent wave of SOE equitization, has led to an increased presence of foreign investors in the stock market.<sup>18</sup> Foreign holdings, however, remain insignificant in a still-nascent bond market.<sup>19</sup> In addition, the housing law amendment in 2015 to allow non-residents to own properties in Vietnam led to more FDI in the real estate sector. Meanwhile, external borrowings by domestic entities—including via the issuance of bonds abroad—remain capped by external debt thresholds and annual net borrowing limits (Table B2). Similarly, capital outflows are subject to more stringent controls. So far, most outward investment flows have been in the form of direct investment abroad and approval is required from the Parliament or Prime Minister for large-sized projects.<sup>20</sup>

**Table B2. Capital Flow Regulations**

	Inflows	Outflows
<b>Current account transactions</b>		
Cross-border exchange control	There is no limit on the amount to be brought into Vietnam, but any amount in excess of USD5,000 must be declared upon entering Vietnam.	Any amount in excess of USD5,000 must be declared upon departure and accompanied with proof documents specified by the SBV.
External trade proceeds	Residents having forex income from export of goods and services are required to transfer those revenues into foreign currency accounts opened at licensed credit institutions in Vietnam, but no conversion is required.	Vietnamese importers are allowed to purchase foreign currencies at licensed credit institutions to settle the payment for their imports of goods and services.
Primary income transfer	Profits earned by Vietnamese firms investing abroad are required to be repatriated within six months from the date of the final tax report, except for those allowed to be retained for re-investment purposes.	A withholding tax of 5 percent is applicable on the interest earned from non-residents' investment in domestic bonds.
Secondary income transfer	No minimum holding period and conversion are required. Recipients of overseas remittances have the freedom to deposit the remittances into either dong or foreign currencies deposits, and are exempted from taxes and fees.	Non-residents' sale of Vietnamese equities is subject to a deemed tax of 0.1 percent of the gross sales proceeds.
<b>Capital and financial account transactions</b>		
Direct investment		Projects of VND20,000 billion (or approximately USD870 million) and above need Parliament's approval while projects from VND400 billion (about USD17 million) in banking and insurance, broadcasting and publishing, and telecommunication, or from VND800 billion (or about USD35 million) in other sectors are subject to the Prime Minister's approval.  Foreign exchange transfer prior to the grant of investment permit is limited to 5 percent of total investment size and not exceeding USD300,000.
Portfolio investment	A general 49 percent foreign ownership limit for public companies has been removed since 2015.	Portfolio investments abroad are allowed through engaging with securities firms or other financial intermediaries overseas.
Other investments		
ST borrowings	The growth rate of short-term external debt is capped at 16-18 percent annually between 2020-2022.	
MLT borrowings	Net medium to long-term borrowings, together with bonds issued abroad, are capped at USD5.50-6.09 billion annually for 2020-2022.	

Source: AMRO compilation from the Foreign Exchange Ordinance 2005 and 2013, Investment Law 2014 and 2020, Prime Minister Decision 1130 dated July 2020 approving the Public Debt Management Program for 2020-2022, and other legislations related to capital flow management in Vietnam.

<sup>18</sup> The average foreign ownership in Vietnamese listed firms increased from about 12 percent in 2012 to 23 percent in 2018 (Sources: Batten and Vo (2015) and Nikkei Asia (2018)).

<sup>19</sup> According to the AsianBondsOnline database of the Asian Development Bank, as of end-2020, the share of foreign holding in total LCY government bonds outstanding in Vietnam stood at less than 1 percent, compared to around 25 percent in Indonesia and Malaysia, and 14 percent in Thailand.

<sup>20</sup> Investment Law in 2014, which has been replaced by Investment Law in 2020.

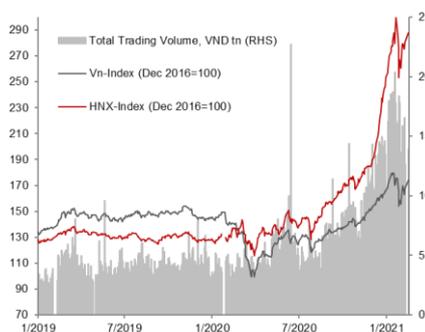
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**A.3 The financial market remains strong and continues to deepen**

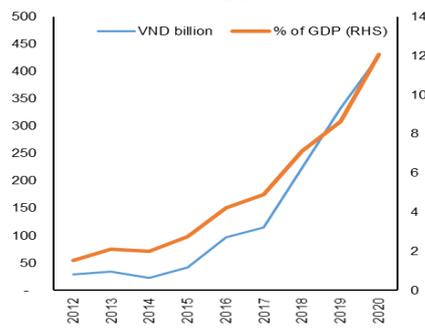
**7. Abundant liquidity, effective management of the pandemic and relatively strong performance of listed companies supported the equity markets, while the expanding industrial sector supported the real estate market.** After experiencing a drop in early 2020 amid a major selloff in global equity markets following the COVID-19 outbreak, the stock market steadily erased the early loss as the year wore on and the pandemic came under control in Vietnam (Figure 10). Ample liquidity in the financial market, the country’s effective pandemic crisis management relative to other regional economies, as well as the resilient performance of listed companies, helped shore up the VN index, which rose by around 14 percent in 2020. As for the real estate market, transaction activity in the residential sector was relatively subdued in light of pandemic-related social and travel restrictions and difficulties in obtaining licenses for land development, while the industrial sector’s performance was kept buoyant by continued strong demand due to relocation of manufacturing activity from overseas, particularly China.

**Figure 10. Equity Indices and Trading Volume**



Source: CEIC; AMRO staff calculations

**Figure 11. Corporate Bond Issuance Volume**



Source: VMOF; AMRO staff calculations

**8. The authorities have strengthened the regulatory framework to bring the rapidly growing corporate bond market under control.** Corporate bond issuance has been gathering momentum in Vietnam over the past few years in part due to the SBV’s stricter supervision of banks’ lending to the real estate sector and, more recently, due to low interest rates on bank deposits, which have driven some individuals to invest in higher-yield corporate bonds (Figure 11). The amount of corporate bonds outstanding has increased from 5 percent of GDP in 2017 to 12 percent in 2020. The lion’s share of the

recent issuance has been driven by banks and real estate companies.<sup>21,22</sup> Against this backdrop, the authorities issued a regulation in July 2020, aimed at improving issuance conditions, strengthening information disclosure, minimizing risks in the corporate bond market.<sup>23</sup> Regulations on corporate bond issuance have been enhanced further with the Securities Law, the Enterprise Law, and guiding Decrees coming into force at the beginning of 2021, whereby the legal framework for corporate bond issuance is strengthened, especially with regard to transparency in the process of capital mobilization.<sup>24</sup>

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<sup>21</sup> Since the SBV's supervision of banks' activities extends to bond issuance, for the most part aimed at securing medium- to long-term funding as well as bolstering capital positions, the risk level of bank bonds may not be as high as real estate bonds, which are often issued without credit ratings or collateral.

<sup>22</sup> Banks and real estate companies accounted for 28 percent and 35 percent respectively of total private placement of corporate bond issuance in 2020.

<sup>23</sup> Amending Decree 163/2018/ND-CP, Decree 81/2020/ND-CP was endorsed on July 9 and became effective from September 1, 2020.

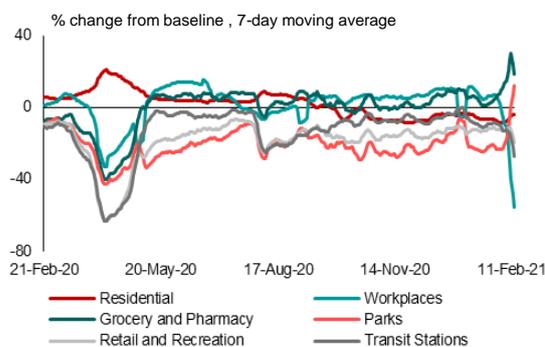
<sup>24</sup> The new securities law covers a number of aspects, including public company criteria, private placement, IPOs and tender offers. Some of the key points of the new law are stricter criteria to achieve the status of public company and more stringent requirements for private placement and IPOs.

## B. Risks, Vulnerabilities and Challenges

### B.1 Downside risks continue to stem from the ongoing pandemic

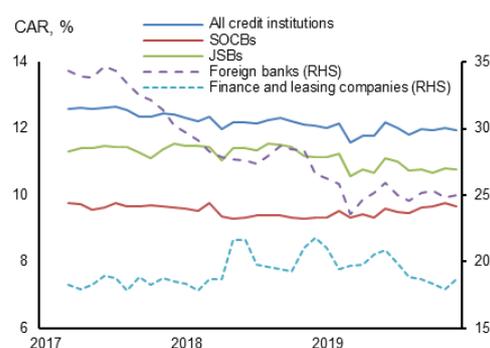
**9. Key external and domestic risks stem mainly from the uncertainty over the impact of the pandemic and its evolution.** A protracted and uneven recovery of the global economy may jeopardize the recovery in external demand. In addition, supply chain disruptions due to renewed border closures and ongoing U.S.-China trade tensions may pose an obstacle to recovery from the supply side. While domestic demand has picked up after a relatively successful containment of the pandemic, the recovery remains susceptible to the risk of further waves of COVID-19 infection, to which the service sector is particularly vulnerable (Figure 12 and Box C). Moreover, lasting scars from the pandemic, such as the corporate sector’s financial distress—especially the MSMEs—and the pandemic’s impact on labor and employment, may undermine the strength of economic recovery in the period ahead (Box C).<sup>25</sup>

**Figure 12. Mobility to Individual Places**



Sources: Haver Analytics, sourced from Google COVID-19 community mobility reports; AMRO staff calculations. Note: Google Community Mobility data show how visits and lengths of stay at different places change compared to a baseline. Changes for each day are compared to the baseline for that day of the week, whereby the baseline is the median value, for the corresponding day of the week, during the preceding 5-week period.

**Figure 13. Capital Adequacy Ratios**



Source: State Bank of Vietnam; IMF; CEIC; AMRO staff calculations

### Box C. The Impact of the COVID-19 Pandemic on Businesses and Labor in Vietnam<sup>26</sup>

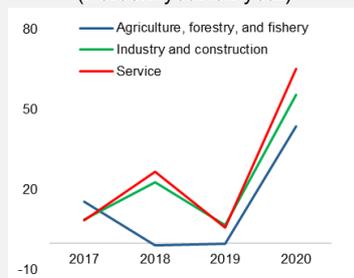
**The number of temporary business closures increased significantly due to the COVID-19 pandemic in 2020.** The General Statistics Office of Vietnam (GSO) estimated that around 46,600 Vietnamese enterprises temporarily ceased operations, an increase of 62.2 percent from the previous year (Figure C1). The pattern of business closures was consistent with the national lockdown in April and the subsequent mobility restrictions in July after the Da Nang outbreak. However, thanks to the government’s effective containment measures, the domestic economy

<sup>25</sup> Compared to the Global Financial Crisis, Vietnamese firms have relied more on workhour reduction than outright employment termination during the pandemic. While this strategy helps limit the increase in unemployment and makes it easier for firms to obtain more workhours when the economy further picks up, it has resulted in widespread underemployment and income reduction for workers.

<sup>26</sup> This box was prepared by Hoang Viet Phuong.

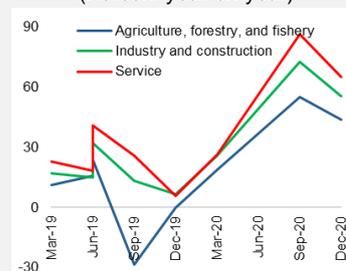
has gradually recovered since September, which has helped slow the growth in temporary closures (Figure C2).

**Figure C1. Annual Changes in the Number of Temporary Business Closures (Percent year-on-year)**



Source: GSO; CEIC; AMRO staff calculations

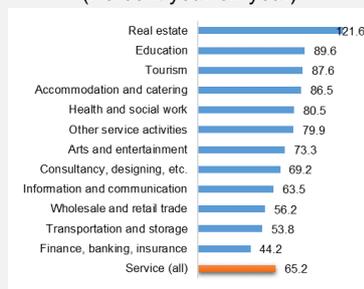
**Figure C2. Quarterly Changes in the Number of Temporary Business Closures (Percent year-on-year)**



Source: GSO; CEIC; AMRO staff calculations

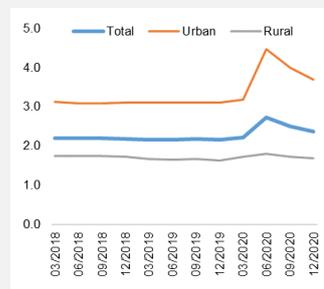
**The service sector was most affected by the pandemic, accounting for around 70 percent of total business closures in 2020.** Businesses in the tourism, hospitality, transportation and real estate sectors were most severely affected, due to a sharp decline in international travellers, a drop in aggregate demand and cash flow shortage (Figure C3). However, an increase in domestic tourism has somewhat absorbed the negative impact of the slump in international arrivals on the tourism sector.

**Figure C3. Increase in the Number of Temporary Business Closures by Sector (Percent year-on-year)**



Source: GSO; CEIC; AMRO staff calculations

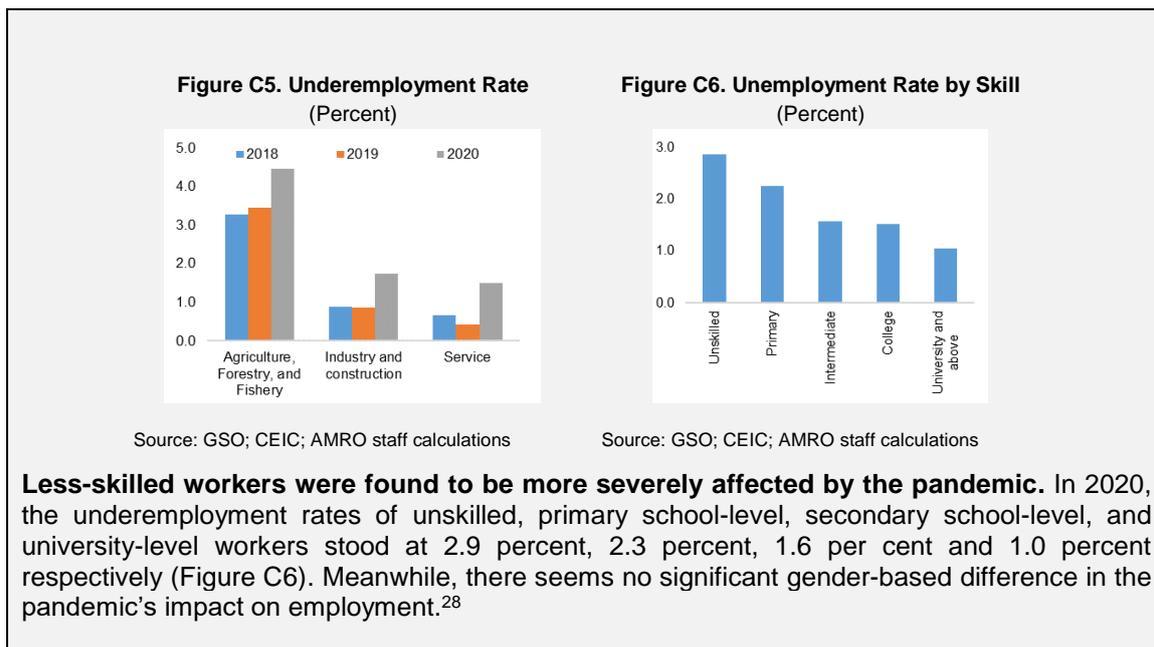
**Figure C4. Unemployment Rate (Percent)**



Source: GSO; CEIC; AMRO staff calculations

**The COVID-19 pandemic affected a significant fraction of the Vietnamese labor force.** Among workers aged 15 and above nationwide, around 40 percent were subjected to staggered working hours or rotating leave, while about 14 percent were laid off or ceased participation in economic activities. From an earnings perspective, the pandemic has reduced the incomes of 69 percent of workers. Unemployment soared in urban areas, while underemployment increased sharply across business sectors (Figures C4 and C5). The GSO estimated that the pandemic likely deprived 1.6 million people of the opportunity to enter the labor market.<sup>27</sup>

<sup>27</sup> GSO (2021). "Covid-19 Impact on Labor and Employment Situation in Quarter IV of 2020".



**10. Risks in the financial sector may arise from the impact of COVID-19 pandemic measures on asset quality and trends in banks' loan portfolios.** The banking system's NPL ratio rose from 1.63 percent as of end-2019 to 1.69 percent as of end-2020. Despite banks' efforts on loan restructuring, it is likely that the banks' asset quality will further deteriorate and erode their relatively thin capital buffers (Figure 13).<sup>29</sup> Vulnerabilities may also emerge from banks' increased holdings of corporate bonds. Furthermore, the SBV's forbearance policy on loan classification has made it difficult to ascertain the true extent of the deterioration in asset quality and thus more challenging to accurately assess banking system soundness.

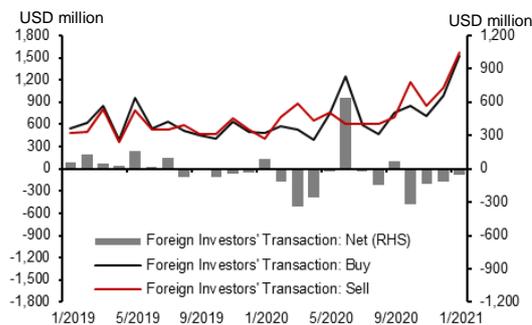
## B.2 Other external risks demand vigilance

**11. Uncertainties in global financial markets could lead to increased volatility in capital flows.** Heightened risk aversion as well as policy surprises in major economies could lead to renewed turbulence in asset prices and capital outflows (Figure 14). However, Vietnam may be less vulnerable than other regional economies due to its limited exposure to non-residents' portfolio investment compared to foreign direct investment (Figure 15). In addition, the country's relatively resilient economic growth has been accompanied by robust performance of listed companies, which helps lessen the possibility and severity of potential outflows.

<sup>28</sup> Dang, Hai-Anh and Cuong Viet Nguyen (2020). "Did a Successful Fight against the COVID-19 Pandemic Come at a Cost? Impacts of the Outbreak on Employment Outcomes in Vietnam". IZA Discussion Paper # 13958.

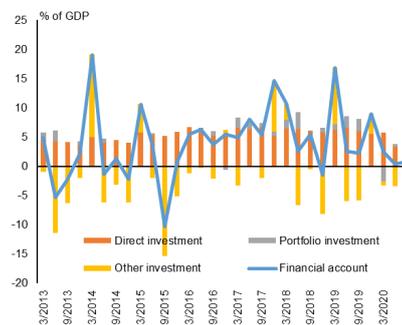
<sup>29</sup> That said, credit risk may be limited as a result of many banks' conservative approach in loan restructuring.

Figure 14. Foreign Investors' Equity Transactions



Source: CEIC; AMRO staff calculations

Figure 15. Financial Account



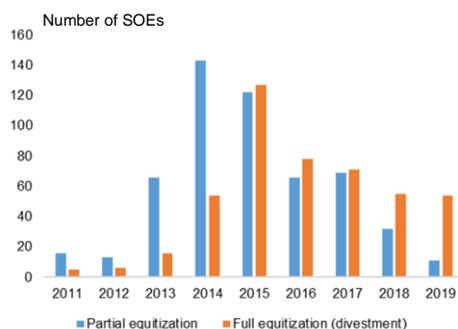
Source: CEIC; AMRO staff calculations

**12. The U.S. allegation of currency manipulation could lead to the imposition of some trade measures on Vietnam's exports to the U.S.** Potential actions by the U.S. for the most part may include measures to reduce the trade surplus with the U.S. – such as countervailing measures or tariff increases on the exports of certain Vietnamese products, agreements to purchase U.S. imports and limits on access to U.S. development financing. However, how the new U.S. administration will deal with the issue remains to be seen.

**B.3 Structural challenges remain**

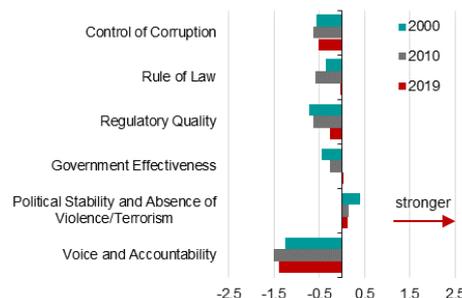
**13. A number of structural challenges may impede the country's long-term growth prospects as the economy continues to develop.** First, Vietnam's rapid growth has not been accompanied by sufficient infrastructure development, in particular transport infrastructure such as highways and port facilities. Another fundamental challenge facing Vietnam is the relative inefficiency in resource allocation. The state-owned enterprises (SOEs) still command a significant share of the economy and can at times impede private sector development, while SOE equitization have become slow (Figure 16). Meanwhile, tardy development of domestic supporting industries has been one of the key reasons for the country's difficulty in increasing domestic value added in global value chains (Selected Issue: Evolution of Vietnam's Exports and Global Value Chain (GVC) Participation). Moreover, a number of institutional frameworks are yet to be on par with international standards, while some long-term development goals have been lagging in progress (Figure 17).

Figure 16. SOE Equitization Progress



Source: State Bank of Vietnam; CEIC; AMRO staff calculations

Figure 17. Worldwide Governance Indicators (Score -2.5 to +2.5 [strongest])



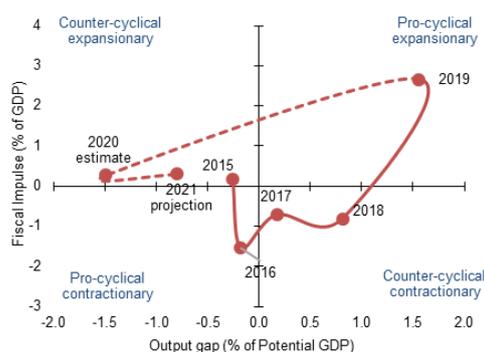
Source: World Bank; AMRO staff calculations

## C. Policy Discussions and Recommendations

### C.1 Continued policy support is warranted for a strong recovery

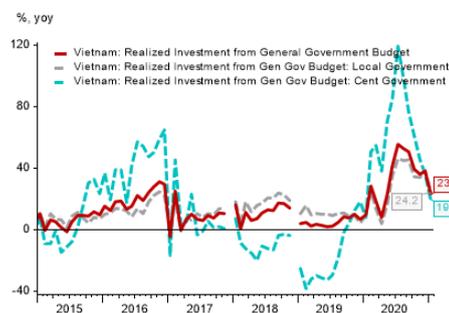
**14. Given the lingering uncertainty over the growth prospects, fiscal policy should continue to support the economy.** Compared to other regional economies, Vietnam’s fiscal stimulus to mitigate the impact of COVID-19 has been relatively modest.<sup>30</sup> In light of its relatively sufficient fiscal buffer (Box D) and with economic recovery still subject to heightened uncertainty, greater fiscal support through both revenue and expenditure measures may be warranted to support the nascent economic recovery and facilitate the transition to the post-pandemic “new normal”, while targeted support to MSMEs and low-income households needs to continue and be regularly reviewed for their relevance and effectiveness (Figure 18). Furthermore, enhancement of support programs through simpler and better-targeted disbursement will help facilitate the effective use of government funds.<sup>31</sup> In addition, it is important to ensure continued implementation of the public investment programs with a view to shoring up growth in the short term and further developing the country’s physical infrastructure to facilitate private investment in the medium to long term (Figure 19).

Figure 18. Fiscal Impulse and Output Gap



Source: CEIC; AMRO staff calculations  
Note: Based on AMRO’s GDP estimates

Figure 19. Public Investment



Source: GSO; Haver Analytics; AMRO staff calculations

#### Box D. Vietnam’s Debt Sustainability Analysis<sup>32</sup>

**Vietnam’s public debt-to-GDP ratio is forecast to decline over the medium term.** The key baseline assumptions for the next five-year period are: (i) average real GDP growth of around 6-7 percent; (ii) a contractionary fiscal stance with an average fiscal deficit below 4 percent; (iii) FX depreciation of about 0.5 percent per year; and (iv) a stable domestic real interest rate that increases slightly over time (Figures D1 and D2).<sup>33</sup> According to the analysis, Vietnam’s public debt-to-GDP

<sup>30</sup> For example, the cash transfer support package amounted to only 36 trillion VND (about 0.4 percent of GDP) and only around 35 percent of the target amount had been disbursed as of end-October 2020.

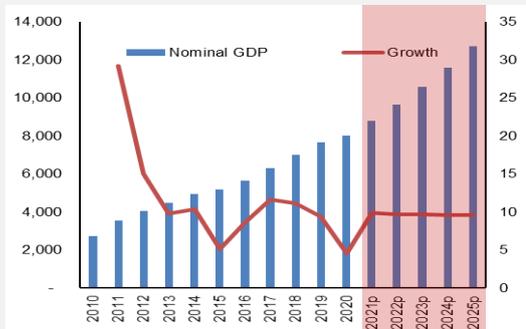
<sup>31</sup> For example, stringent information requirement and lack of clarity with respect to eligibility criteria were some of the reasons behind the relatively low disbursement of supports to affected households and businesses in 2020.

<sup>32</sup> This box was prepared by Nguyen Thang Long.

<sup>33</sup> Specifically, the assumptions are as follows: potential growth will be maintained at around 6.5 percent (the pre-pandemic level. See Selected Issue: Vietnam’s Strong FDI as a Driver of Economic Growth), which is in line with the government’s

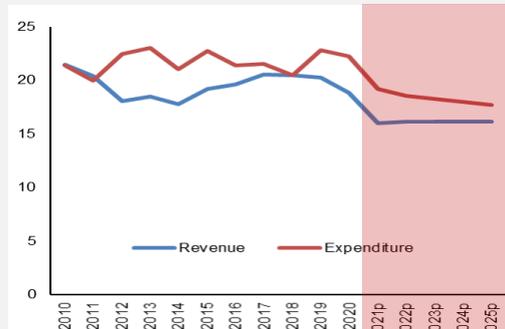
ratio is projected to decline gradually from 43.6 percent of GDP in 2020 to 38.1 percent of GDP in 2025.<sup>34</sup>

**Figure D1. Nominal GDP Projection**  
(VND trillion; Percent year-on-year)



Source: VMOF; AMRO staff calculations

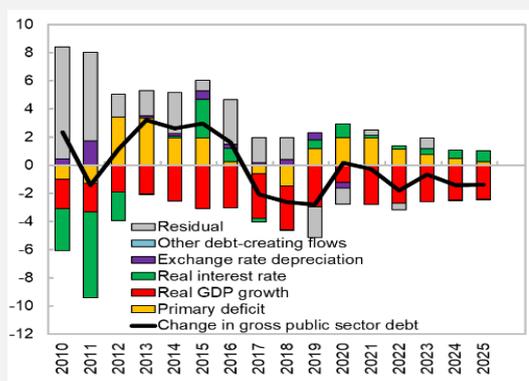
**Figure D2. Revenue and Expenditure**  
(Percent of GDP)



Source: VMOF; AMRO staff calculations

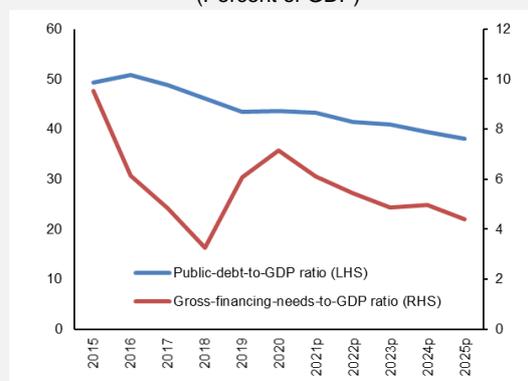
**Robust GDP growth and declining primary deficit are expected to bring down the debt to GDP ratio in the medium term (Figure D3).** The most significant contributor to the projected reduction in the ratio is the strong GDP growth, while the key offsetting factors are the domestic real interest rate and the primary deficit, which are expected to be kept under control, leading to a reduction in the debt ratio. The impact of exchange rate depreciation is expected to be minor, given the government has been relying mainly on domestic financing, and most of the existing external government debt is concessional.

**Figure D3. Public Debt Dynamics**  
(Percent of GDP)



Source: VMOF; AMRO staff calculations

**Figure D4. Baseline Projections for Public Debt and Gross Financing Needs**  
(Percent of GDP)



Source: VMOF; AMRO staff calculations

**Vietnam's public debt trajectory is most vulnerable to the two types of shocks: a decline in growth rate and an increase in the primary deficit.** In order to assess the vulnerability of public debt, different scenarios are considered with shocks to the growth rate, the primary balance, the real interest rate and the exchange rate.<sup>35</sup> The ratio of public debt to GDP is projected to trend downward in the medium term under all single-shock scenarios (Figure D5). Even under the combined shock scenario, the debt ratio declines gradually after peaking at 46.1 percent of GDP in

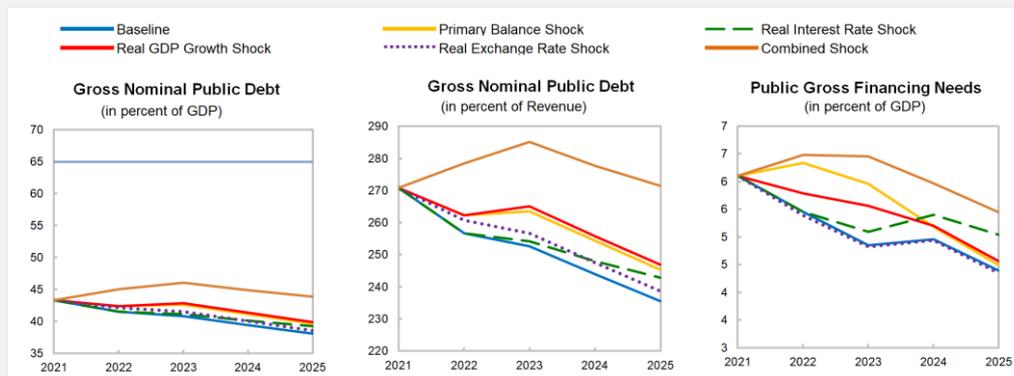
target for the next five-year medium-term economic plan; the fiscal deficit is assumed to be lower than the government's plan based on AMRO staff's projection of higher revenue collection than that of the five-year plan.

<sup>34</sup> Based on AMRO's 2020-2025 GDP projections.

<sup>35</sup> The growth shock is a reduction in the real GDP growth rate by one standard deviation over the past ten years (about a 1-percentage-point drop in the growth rate). The primary balance shock is a 0.5-ppt decrease in the primary balance, which is approximately the estimated reduction of in the primary balance in 2020 due to the pandemic. The interest rate shock is an increase of about 500 basis points, taking the highest real interest rate increase over the last ten years minus the average projected rate for the next five-year period. The exchange rate shock is a depreciation in the exchange rate of around 10 percent.

2023. Under all shock scenarios, Vietnam’s public debt-to-GDP ratio remains below the threshold of 65 percent as mandated by the National Assembly.

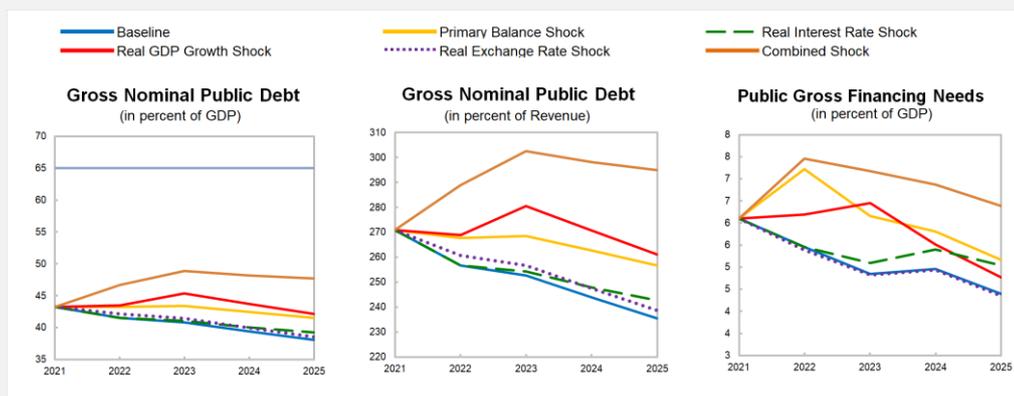
**Figure D5. Standard Stress Test**



Source: VMOF; AMRO staff calculations

To further assess public debt vulnerability in case the economy suffers from a more protracted COVID-19 pandemic, more adverse assumptions are used for growth and the primary balance, which constitute the key drivers of public debt. Specifically, the growth shock assumes a reduction in real GDP growth of 2.8 ppts from the baseline.<sup>36</sup> The primary balance shock considers a 2.2-ppt increase in the primary deficit, which is approximately the difference between the lowest primary deficit in the last ten years and the projected baseline primary deficit in 2021. The interest rate shock and the currency exchange rate shock remain the same as in the standard stress test. Under this adverse stress test, the ratio of public debt to GDP increases to about 48.9 percent of GDP in 2023 and gradually declines after that, leaving the debt ratio still well below the 65-percent threshold (Figure D6).

**Figure D6. Adverse Stress Test**

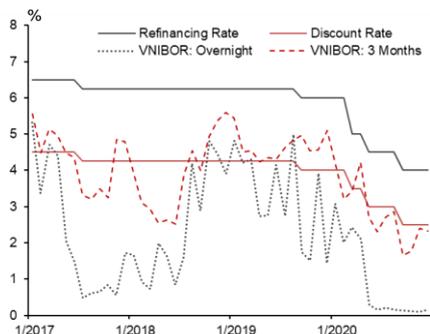


Source: VMOF; AMRO staff calculations

<sup>36</sup> AMRO (2021 forthcoming), “ASEAN+3 Regional Economic Outlook (AREO) 2021, Box 1.2: A Wary Recovery” for the summary of key assumptions for growth scenarios, including Vietnam’s GDP growth ranges for 2021 and 2022.

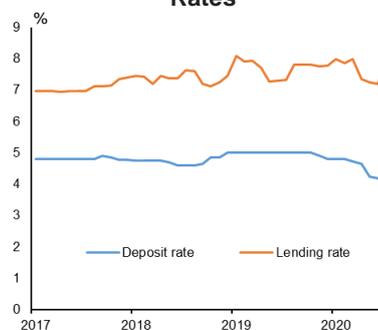
**15. The easing of monetary and macroprudential settings has been appropriately supportive of the economy.** On the monetary policy front, the rate cuts led to a substantial easing of monetary conditions and a reduction in banks' financing costs (Figures 20 and 21). The extension of the deadline for the phased reduction of the ratio of short-term funding to medium- to long-term loans also helped banks extend credit with less concern over liquidity constraints. Going forward, given the benign inflation outlook, monetary policy should remain supportive of the economic recovery, by keeping financing costs affordable for households and businesses, especially as policy rate reductions have yet to be fully transmitted to lending rates. Asset prices and leverage conditions need to be closely monitored and taken into consideration in determining when and how the policies should be adjusted going forward. Over the longer term, it is crucial ongoing efforts to strengthen monetary policy transmission be maintained, including through the use of more price-based mechanisms with a view towards greater efficacy in credit allocation.<sup>37</sup>

**Figure 20. Policy and Interbank Rates**



Source: State Bank of Vietnam; IMF; CEIC; AMRO staff calculations

**Figure 21. Average Deposit and Lending Rates**



Source: IMF; CEIC; AMRO staff calculations

**16. With continuing uncertainty over the strength of the post-pandemic global recovery, the authorities' efforts to strengthen the external buffer can be supported by allowing greater flexibility in the exchange rate.** Despite the country's strong current account balance, heavy reliance on imported intermediate goods for the production of manufacturing exports has kept Vietnam's import cover relatively low, especially compared to regional peers.<sup>38</sup> In this regard, AMRO has supported the authorities' continued efforts to strengthen the buffer by accumulating foreign reserves to better withstand potential external shocks.<sup>39</sup> Supported by a strong export performance of goods and services, FDI inflows, as well as remittances, Vietnam has built up its foreign reserves to around 4.3 months of imports as of end-2020. Considering uncertainties in the global economic environment, the country should continue strengthening the external buffer, while increasing the flexibility of its exchange rate as a buffer against external shocks.

<sup>37</sup> While a number of administrative measures (e.g. credit quotas and interest rate caps) are still in place, the authorities have increasingly relied more on market-based instruments, such as the overnight market operations (OMO) rate, in their conduct of monetary policy.

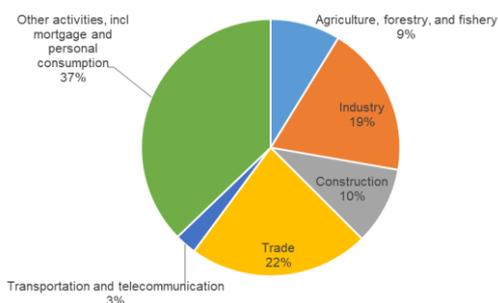
<sup>38</sup> For example, the average import cover for ASEAN-4 countries (Indonesia, Malaysia, the Philippines, and Thailand) was approximately 7 months in 2019.

<sup>39</sup> AMRO's Annual Consultation Report on Vietnam 2018.

## C.2 Financial supervision continues to be vital

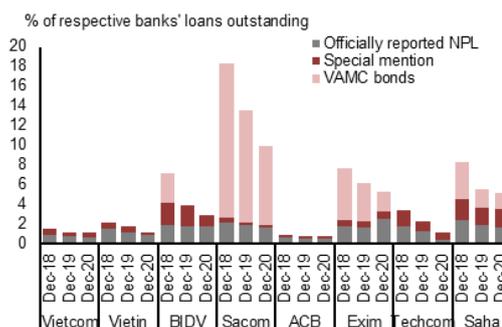
**17. With more accommodative financial conditions, enhanced supervision continues to be essential.** The SBV’s heightened supervision of lending to risky sectors remains warranted to mitigate the risk of an asset bubble. In addition, enhanced supervision in this sector is essential in order to safeguard the quality of bank credit in the period ahead, especially in light of a likely buildup in COVID-19 impaired assets as well as the loss of household income (Figure 22). Meanwhile, the forthcoming three-year roadmap on normalization of provisioning is a welcome move, as are the forthcoming expansion in the coverage and extension of the timeline for debt rescheduling, where regulatory forbearance with regard to loan classification warrants regular monitoring with a view to maintaining transparency in the banking system. Lastly, although most banks have completed the required provisioning for their VAMC bonds and the authorities have made considerable progress in bank recapitalization,<sup>40</sup> greater efforts should be made to raise the capital buffers of banks, especially with the expected increase in provisioning needs for impaired assets upon the eventual expiration of regulatory forbearance (Figure 23).<sup>41</sup>

Figure 22. Composition of Bank Loans, 2019



Source: State Bank of Vietnam; CEIC; AMRO staff calculations

Figure 23. NPL, SML, and VAMC Bonds



Source: Financial reports; AMRO staff calculations

### Authorities’ Views

The SBV fully recognizes the potential impact of the pandemic on banks’ portfolios and lending activity and has implemented a number of measures to alleviate such impact. The SBV continues to closely monitor the operations of credit institutions, especially the evolution of different types of debt, as well as credit extension to large customers, especially in the field of construction and real estate. Moreover, the SBV is working with credit institutions, particularly those with rapidly increasing bad debt and those expecting a high level of bad debt, to develop debt resolution plans in accordance with the provisions of Resolution 42/2017/QH14. Regarding regulatory forbearance, strict stipulations are in place, requiring credit institutions to report regularly to the SBV the conditions of outstanding loans likely to become bad debt and those whose classification has been maintained. In addition, the SBV is currently assessing the impact of an

<sup>40</sup> For example, the authorities have allowed state-owned banks (Decree 121/2020/ND-CP) and encouraged all commercial banks to pay dividends in stocks to increase capital.

<sup>41</sup> That said, the rapid economic recovery since the second half of 2020 as well as the surge in credit extension towards the end of the year helped many banks achieve considerable profits in 2020, which would allow them to strengthen capital buffers as needed going forward.

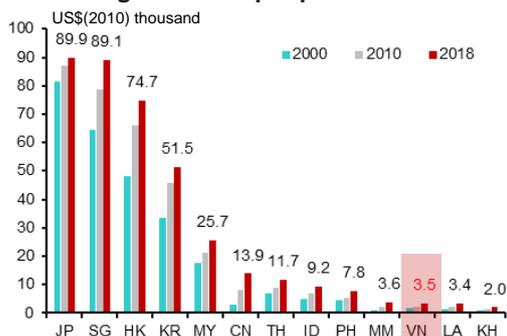
amendment of the existing policy for loan restructuring and regulatory forbearance (Circular No. 01/2020/TT-NHNN) in order to ensure support for clients affected by the pandemic. The SBV also requires credit institutions to have an appropriate roadmap for loan provisioning with a view to ensuring banking system soundness.

As far as the corporate bond market is concerned, the SBV is currently building a legal framework to support sustainable development while improving the requirements and standards of governance for credit institutions that participate in the corporate bond market.

### C.3 Structural reforms remain essential

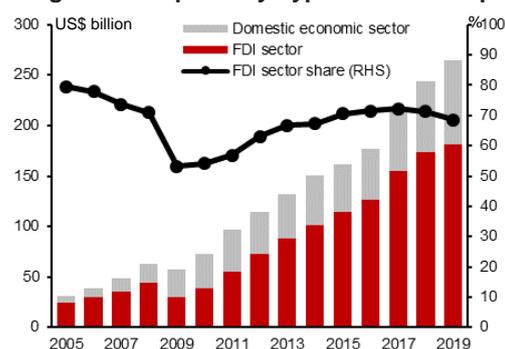
**18. Structural reforms should be accelerated to bolster economic recovery and ensure a sustainable development path.** With SOE equitization slowing in recent years, resolving structural obstacles, such as SOE governance and financial transparency, is critical to improving productivity and enhancing growth potential (Figure 24, Box E). Further efforts to develop domestic supporting industries are increasingly needed amid strong FDI flows into Vietnam, in order to increase the country's participation and domestic value added in the global value chains (GVCs) (Figure 25). Meanwhile, the expanded number of FTAs augurs well for Vietnam's export sector and provides impetus to enhance institutional frameworks and improve the business environment.<sup>42</sup> However, the authorities should assist domestic firms in upgrading their products and meeting relevant criteria to take full advantage of tariff reductions and in improving efficiency. As far as human capital is concerned, improvement in tertiary education and greater emphasis on technical and vocational programs are some of the key priorities in the country's effort to boost labor productivity. Additionally, it is essential to ensure continued support for long-term development issues, such as infrastructure development, the social safety net and public health, while carefully managing risks to long-term fiscal sustainability.

Figure 24. Output per Worker



Source: World Bank (2020, Global Productivity Trends)

Figure 25. Exports by Type of Ownership



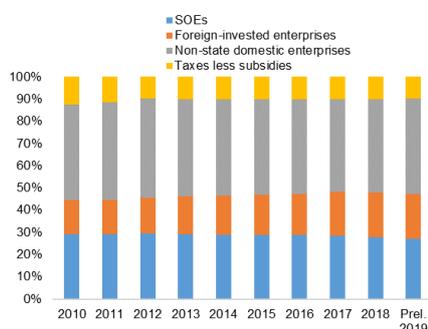
Source: GSO via Haver Analytics; AMRO staff calculations

<sup>42</sup> Recently signed so-called “new-generation FTAs,” which tend to be more comprehensive than the older variant, bring both risks and challenges. For example, the agreements’ requirements on labor and environmental standards, some of which are still lacking in Vietnam, tend to expedite changes in domestic regulations.

**Box E. Recent Developments on SOE Performance and Reforms<sup>43</sup>**

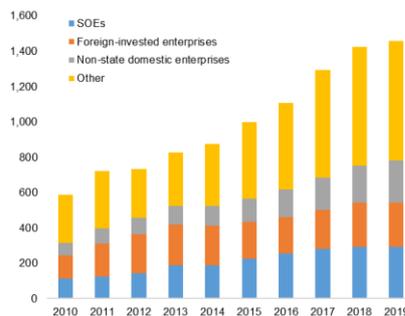
**The SOE sector is one of the main pillars of Vietnam’s economy.** While SOEs’ contribution to GDP and the state budget has been declining over the past several years, it is still relatively significant, at about 28 percent of GDP and 20 percent of the state budget (Figures E1 and E2). In a bid to achieve the status of a market-based economy with a socialist orientation, the government has encouraged the private sector’s active participation in the national economy while also initiating reforms to enhance SOEs’ efficiency.

**Figure E1. Contribution to GDP**  
(Percent of GDP)



Source: GSO; AMRO staff calculations

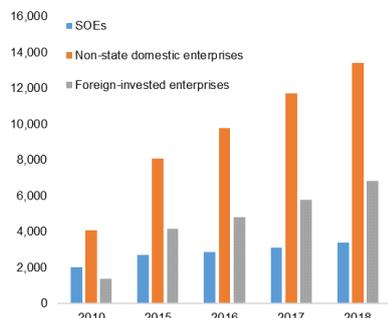
**Figure E2. Contribution to the State Budget**  
(VND trillion)



Source: GSO; AMRO staff calculations

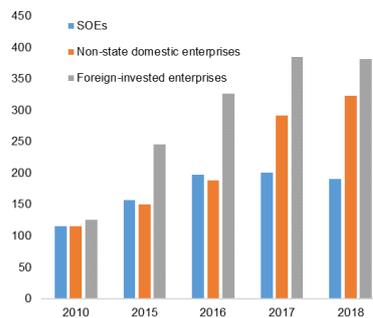
**The performance of SOEs has been stable in recent years, but returns lag those of foreign-invested enterprises (Figures E3, E4, E5, and E6).** SOEs’ relatively modest performance compared to non-state domestic enterprises and foreign-invested enterprises may reflect, to a significant degree, their primary role as public enterprises producing public goods, supporting overall economic development and macroeconomic stabilization.<sup>44</sup>

**Figure E3. Net Turnover**  
(VND trillion)



Source: GSO; Vietnam Whitebook on Enterprises 2020; AMRO staff calculations

**Figure E4. Before-Tax Profits**  
(VND trillion)

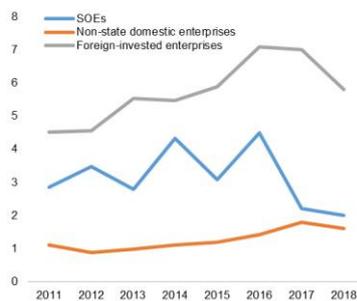


Source: GSO; Vietnam Whitebook on Enterprises 2020; AMRO staff calculations

<sup>43</sup> This box was prepared by Nguyen Thang Long.

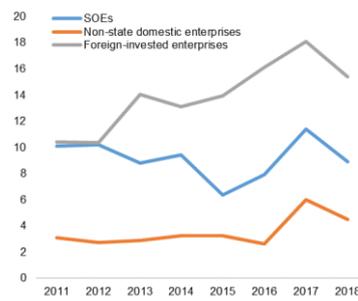
<sup>44</sup> For example, Vietnam Electricity (EVN) and Vietnam Posts and Telecommunications Group (VNPT), two large SOEs, support socioeconomic development in remote areas of Vietnam by bringing electricity and telecommunication facilities to remote areas despite incurring financial losses.

**Figure E5. Return on Assets (Percent)**



Source: GSO; Vietnam Whitebook on Enterprises 2020; AMRO staff calculations

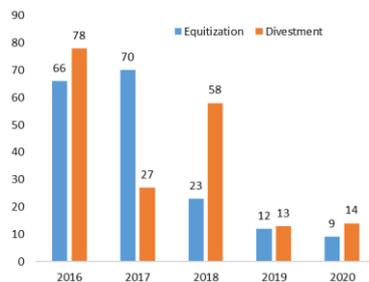
**Figure E6. Return on Equity (Percent)**



Source: GSO; Vietnam Whitebook on Enterprises 2020; AMRO staff calculations

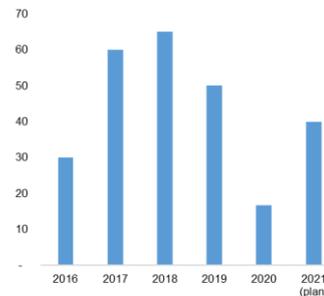
**The pace of SOE equitization and divestment has slowed recently.** Only nine SOEs were equitized in 2020, compared to 180 SOEs equitized during the 2016-2020 period (Figures E7 and E8). While the cumulative number is greater than the original target of 137 SOEs, only 39 of the equitized SOEs were on the list in the original plan. Some of the key reasons behind the slow progress include: i) unfavorable developments in the external and domestic environment, such as ongoing trade tensions and the COVID-19 pandemic; and ii) more stringent regulations in 2016-2020 on the administrative processes concerning SOE equitization and divestment. A Decree (No. 140/2020/ND-CP) was recently introduced to address bottlenecks in the process of equitization and divestment. The government also issued a resolution (No. 161/NQ-CP) to assign greater responsibility and accountability to relevant line ministries and agencies to improve the SOE equitization and divestment process.

**Figure E7. Number of Equitized and Divested SOEs**



Source: VMOF; AMRO staff calculations

**Figure E8. Equitization and Divestment Proceeds Transferred to State Budget (VND trillion)**



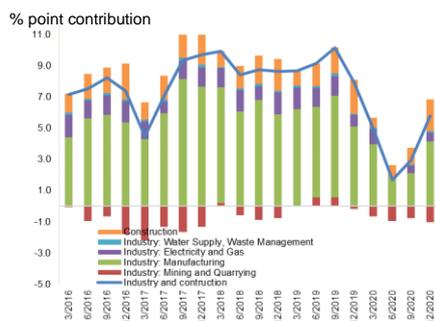
Source: VMOF; AMRO staff calculations

## Appendices

### Appendix 1. Selected Figures for Major Economic Indicators

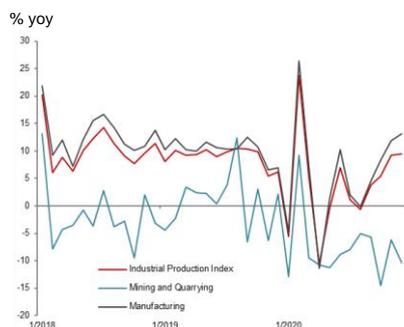
#### Figure 1. Real Sector

Economic growth continued to rebound as growth in manufacturing and construction activity picked up...



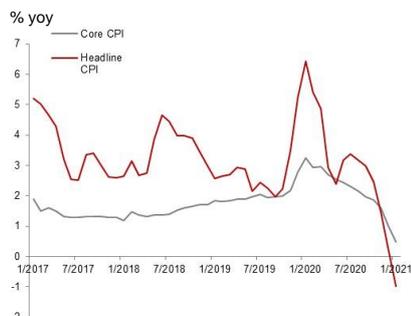
Source: General Statistics Office; CEIC; AMRO staff calculations.

As indicated by GDP data, industrial production has picked up, thanks to a rebound in manufacturing.



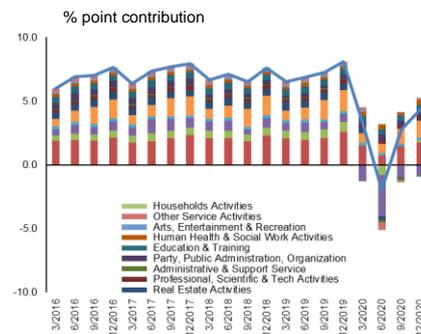
Source: General Statistics Office; CEIC; Nikkei/Markit; AMRO staff calculations

Subdued global oil prices and cooling aggregate demand kept inflation under control in 2020 and brought down core inflation.



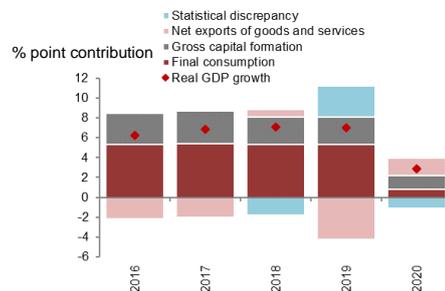
Source: General Statistics Office; CEIC; AMRO staff calculations

...and the service sector bounced back, especially the wholesale and retail sector.



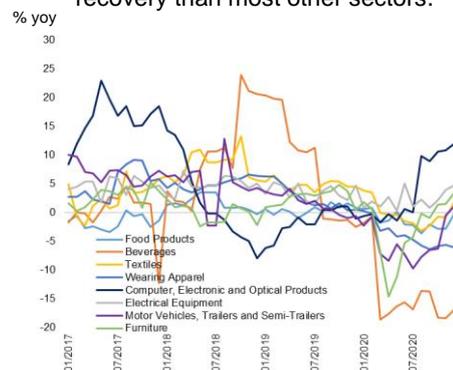
Source: General Statistics Office; CEIC; AMRO staff calculations.

From the demand perspective, exports and investment were the main drivers of growth in 2020.



Source: General Statistics Office; CEIC; AMRO staff calculations

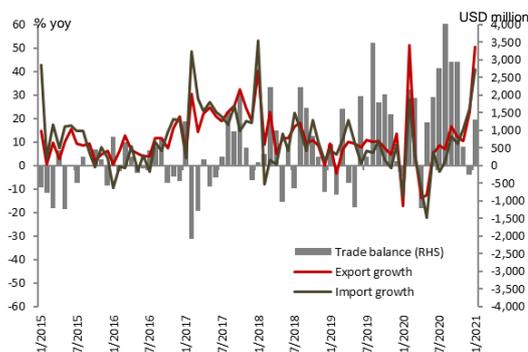
By and large, employment in export-oriented sectors, except textile and apparel, has experienced better recovery than most other sectors.



Source: General Statistics Office; CEIC; AMRO staff calculations

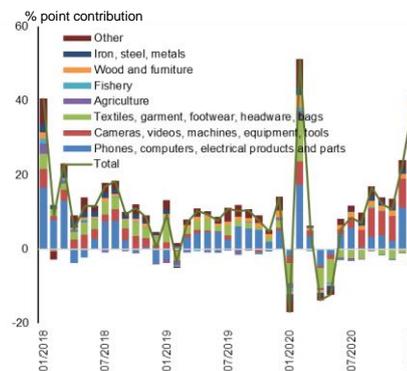
**Figure 2. External Sector**

The improvement in the current account has been driven by a recovery in exports...



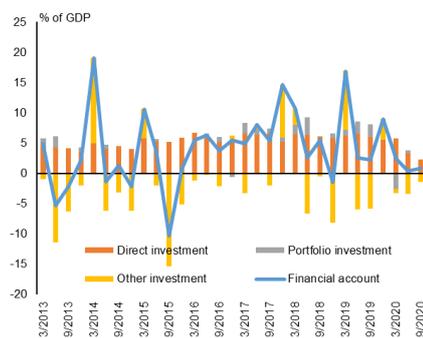
Source: GSO; CEIC; AMRO staff estimates

...which is sustained by resilient growth in the phone/computer and machinery/equipment sectors.



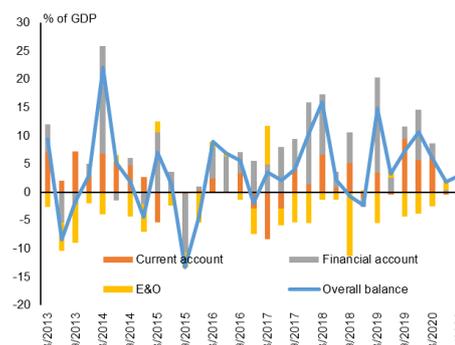
Source: GSO; CEIC; AMRO staff estimates

The financial account surplus narrowed in tandem with weaker FDI inflows (as a percentage of GDP)...



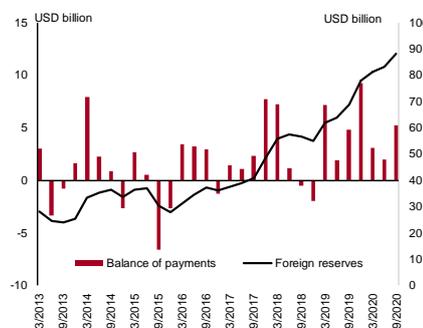
Source: State Bank of Vietnam; CEIC; AMRO staff estimates

As a result, the balance of payments saw a narrowing of overall balance surplus.



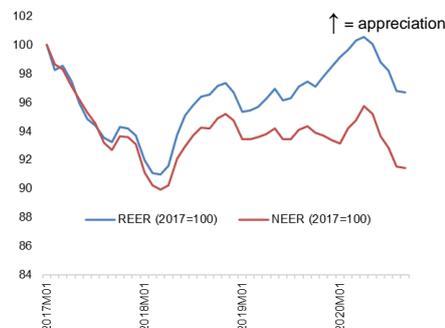
Source: State Bank of Vietnam; CEIC; AMRO staff estimates

The balance of payments surplus led to foreign reserves accumulation.



Source: State Bank of Vietnam; CEIC; AMRO staff estimates

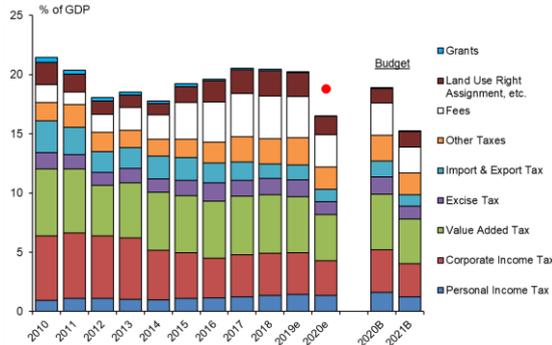
Vietnam's NEER and REER have depreciated since the beginning of 2020.



Source: State Bank of Vietnam; CEIC; AMRO staff estimates

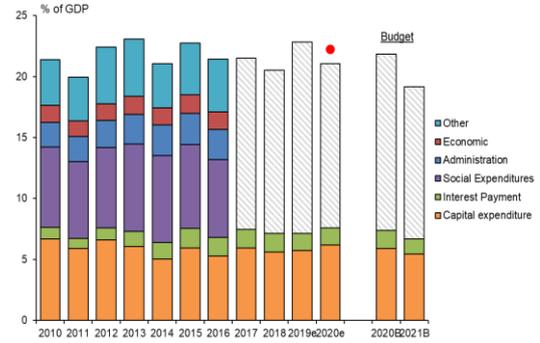
**Figure 3. Fiscal Sector**

Revenue is expected to have declined in 2020, hit by the COVID-19 pandemic...



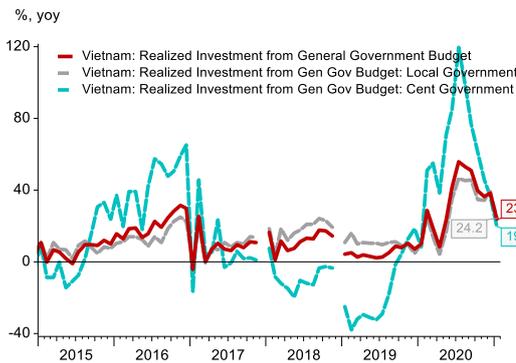
Source: Ministry of Finance; CEIC; AMRO staff calculations  
Note: The column with the 2020 figures is based on the authorities' estimate as of October 2020 (The red dot indicates the estimated final realization for 2020 as of January 2021).

...while the expenditure is estimated to have slightly exceeded the target.



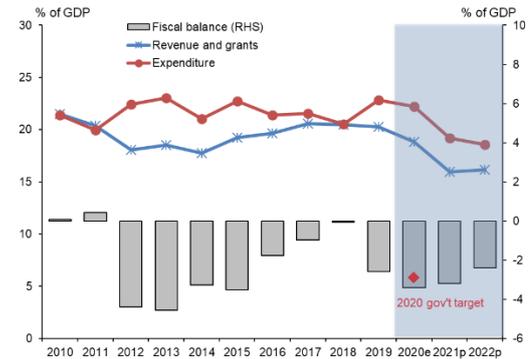
Source: Ministry of Finance; CEIC; AMRO staff calculations  
Note: The column on the 2020 figures is based on the authorities' estimates as of Oct 2020 (The red dot indicates AMRO staff estimates). The shaded area indicate that detailed compositions are not available.

Due to the government's strong efforts, disbursement of public investment expanded sharply in 2020...



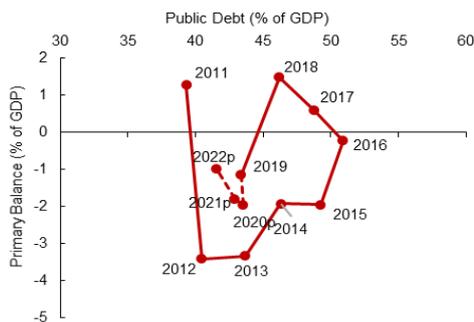
Source: General Statistics Office; Haver Analytics

The 2020 fiscal deficit is expected to have widened to around 3.4 percent of GDP, compared to 2.9 percent target.



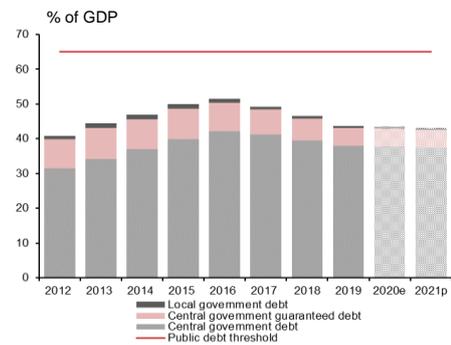
Source: Ministry of Finance; National Assembly Economic Committee; AMRO staff calculations  
Note: The data is based on revised GDP. Based on the old GDP data, the 2020 target is 3.4 percent of GDP.

In 2020-21, the primary balance will deteriorate while public debt will remain low at around 43 percent of GDP...



Source: Ministry of Finance; CEIC; AMRO staff calculations

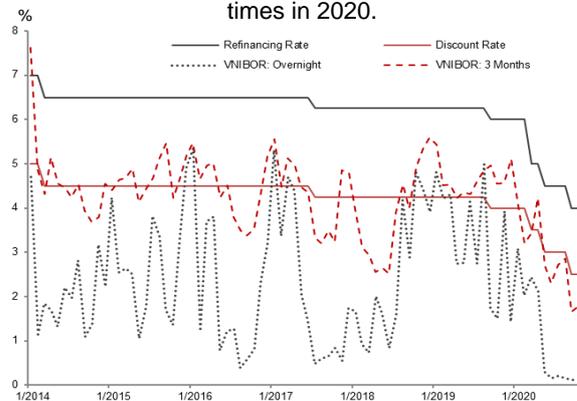
...although fiscal space remains moderate relative to the public debt ceiling of 65 percent of GDP.



Source: Ministry of Finance; CEIC; AMRO staff calculations

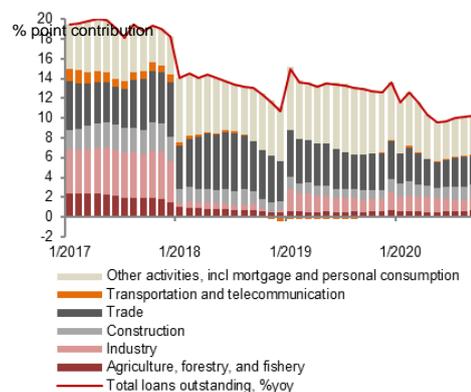
**Figure 4. Monetary and Financial Sector**

Monetary conditions remained accommodative, especially as the SBV lowered key policy rates three times in 2020.



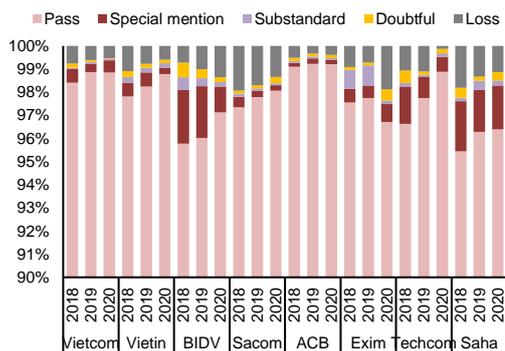
Source: State Bank of Vietnam; IMF; CEIC; AMRO staff calculations

... while loan growth recovered towards the end of 2020.



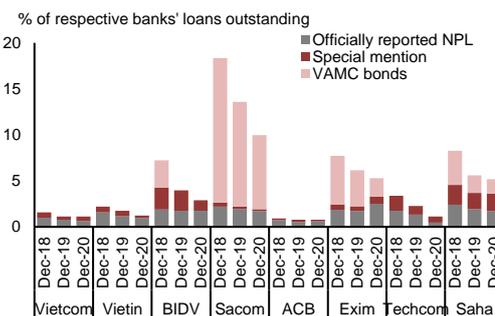
Source: SBV; CEIC; AMRO staff calculations

Banks' asset quality remained stable, in part due to regulatory forbearance.



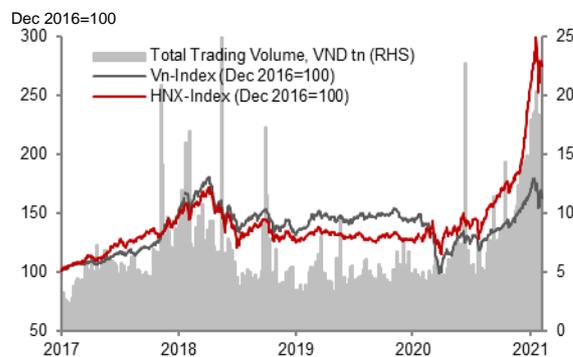
Source: Financial reports; AMRO staff calculations  
Note: The first three banks are SOCBs and the rest are domestic private banks (also known as joint-stock banks).

Banks continued to step up the buy-back of NPLs transferred earlier to VAMC.



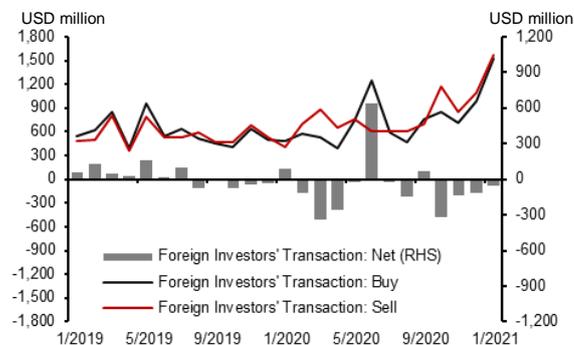
Source: Financial reports; AMRO staff calculations

Ample liquidity, strong corporate performance, and effective control of the pandemic supported the stock market...



Source: National Authorities; CEIC; AMRO staff calculations

... while non-resident outflows moderated in recent months.



Source: National Authorities; CEIC; AMRO staff calculations

## Appendix 2. Selected Economic Indicators

	2017	2018	2019	Estimate	Projection	
				2020	2021	2022
<b>National income and prices</b>	(in annual percentage change)					
Real GDP	6.9	7.1	7.0	2.9	7.0	6.8
Consumer price inflation (average)	3.5	3.5	2.8	3.2	3.2	3.2
<b>Balance of payments</b>	(in USD billion, unless otherwise specified)					
Current account balance	-1.6	5.9	12.5	15.6	16.9	18.6
<i>In percent of GDP</i>	-0.6	1.9	3.8	4.5	4.5	4.5
Trade balance	10.8	16.5	21.2	25.4	27.3	29.3
Exports	215.1	243.7	264.2	284.7	318.9	357.1
Imports	204.3	227.2	243.0	259.3	291.6	327.9
Service balance	-4.0	-3.7	-1.1	-3.4	-3.2	-3.1
Primary income	-17.0	-15.8	-15.3	-14.5	-15.9	-16.6
Secondary income	8.5	8.9	9.2	8.1	8.7	9.0
Financial and capital account balance	20.0	8.5	19.0	8.6	5.0	3.5
<i>In percent of GDP</i>	7.1	2.7	5.8	2.5	1.3	0.8
Direct investment, net	13.6	14.9	15.7	15.3	11.7	10.1
Portfolio investment, net	2.1	3.0	3.0	2.1	2.3	2.4
Other investment, net	4.3	-9.5	0.3	-8.8	-9.0	-9.0
Net errors and omissions	-5.8	-8.3	-8.2	-7.5	-8.0	-8.0
Overall balance	12.5	6.0	23.3	16.7	13.9	14.1
Gross international reserves	49.1	55.5	78.3	95.0	108.9	122.9
<i>In months of imports of goods &amp; services</i>	2.7	2.7	3.6	4.3	4.6	4.7
Coverage of short-term debt by remaining maturity	2.2	2.1	2.9	3.3	3.6	4.3
	(in percentage)					
External debt service/exports of goods and services	4.2	3.3	3.1	2.8	2.6	2.4
Total external debt/GDP	38.9	38.8	39.6	39.4	39.5	39.7
Short-term/total external debt	13.0	13.0	13.5	13.8	13.5	13.2
<b>General government</b>	(in percentage of GDP)					
Revenue and grants	20.6	20.5	20.3	18.8	16.0	16.2
Expenditure	21.5	20.5	22.8	22.2	19.2	18.6
Net lending/borrowing balance	-1.0	-0.1	-2.6	-3.4	-3.2	-2.4
Public debt	48.8	46.2	43.4	43.6	42.9	41.5
<b>Monetary sector</b>	(in annual percentage change)					
Claims on the private sector	17.4	13.8	13.5	12.1	13.5	13.7
Broad money	14.3	12.7	13.6	12.5	13.3	13.4
<b>Memorandum items:</b>						
Exchange rate (VND/USD, period average)	22,374	22,609	23,504	23,202	23,318	23,435
Nominal GDP (in billions of USD)	281.4	309.5	325.7	344.9	377.3	412.0
Nominal GDP (in trillions of VND)	6,294	6,998	7,654	8,003	8,799	9,655
Population (in millions)	94.6	95.5	96.5	n.a.	n.a.	n.a.

Source: National Authorities; CEIC; AMRO staff calculations

Note: Calculations involving GDP are based on the recently revised GDP data for 2010-17 and AMRO staff's GDP estimates from 2018 onwards.

### Appendix 3. Balance of Payments

	2015	2016	2017	2018	2019
	(in billions of USD, unless otherwise indicated)				
<b>Current account balance (I)</b>	-2.0	0.6	-1.6	5.9	13.1
Goods	7.4	11.0	10.8	16.5	21.5
Credit	162.0	176.6	215.1	243.7	264.2
Debit	154.6	165.5	204.3	227.2	242.7
Services	-4.8	-4.3	-4.0	-3.7	-2.4
Credit	11.3	12.5	13.1	14.8	16.6
Debit	16.0	16.8	17.1	18.5	19.0
Primary income, net	-12.2	-14.1	-17.0	-15.8	-15.3
Secondary income, net	7.5	8.0	8.5	8.9	9.2
<b>Capital account (II)</b>	0.0	0.0	0.0	0.0	0.0
<b>Financial account (III)</b>	1.0	10.7	20.0	8.5	19.4
Direct investment, net	10.7	11.6	13.6	14.9	15.6
Inflows	11.8	12.6	14.1	15.5	16.1
Outflows	1.1	1.0	0.5	0.6	0.5
Portfolio investment, net	-0.1	0.2	2.1	3.0	3.0
Inflows	-0.1	0.0	2.1	3.0	3.0
Outflows	0.0	-0.2	0.0	0.0	0.0
Other investment, net	-9.7	-1.1	4.3	-9.5	0.7
Inflows	4.7	4.0	13.9	1.7	8.5
Outflows	14.4	5.1	9.6	11.1	7.8
<b>Errors and omissions (IV)</b>	-5.0	-3.0	-5.8	-8.3	-9.2
<b>Overall balance (= I + II + III + IV)</b>	-6.0	8.4	12.5	6.0	23.3
<b>Reserve assets</b>	-6.0	8.4	12.5	6.0	23.3
<b>Memorandum items</b>					
Foreign reserves	28.3	36.5	49.1	55.5	78.3
Foreign reserves (months of imports of goods and services)	2.0	2.4	2.7	2.7	3.6
External debt	77.8	85.7	104.1	106.9	118.5
o/w short-term	12.0	12.7	21.9	19.6	24.4
Short-term debt (in percent of foreign reserves)	42.4	34.8	44.6	35.3	31.1

Source: National Authorities; CEIC; AMRO staff calculations

## Appendix 4. General Government Fiscal Realizations

	2015	2016	2017	2018	2019
	(in percent of GDP, otherwise indicated)				
<b>Revenue (I)</b>	19.2	19.6	20.6	20.5	20.3
Tax	14.6	14.3	14.7	14.7	14.8
Corporate income tax	3.9	3.3	3.6	3.6	3.6
Personal income tax	1.1	1.2	1.3	1.4	1.4
VAT	4.8	4.8	4.9	5.0	4.8
Excise tax	1.3	1.5	1.4	1.4	1.4
Import & export tax	1.9	1.7	1.5	1.3	1.3
Other	1.6	1.8	2.1	2.1	2.3
Fees, charges, and non-tax	3.1	3.4	3.7	3.6	3.5
Capital revenue	1.6	1.9	2.2	2.2	1.9
Grant	0.0	0.0	0.0	0.0	0.1
<b>Expenditure (II)</b>	22.8	21.4	21.5	20.5	22.8
Current expenditure	16.8	16.2	16.1	15.8	15.1
o/w interest payment	1.6	1.5	1.6	1.5	1.4
Capital expenditure and other	6.0	5.2	5.4	4.7	7.7
<b>Overall balance (= I - II)</b>	-3.6	-1.8	-1.0	0.0	-2.6
<b>Public debt</b>	49.3	50.9	48.8	46.5	43.6
o/w central government debt	39.8	42.1	41.1	39.9	38.1
External	16.7	16.8	16.5	15.4	14.5
Domestic	23.1	25.3	24.6	24.5	23.6
<b>Memorandum items</b>					
Government-guaranteed debt	8.8	8.2	7.2	6.3	5.3
External	4.8	4.5	4.0	3.5	3.0
Domestic	4.0	3.7	3.2	2.8	2.3
Nominal GDP (in trillions of VND)	5191.0	5639.0	6294.0	6943.3	7607.8

Source: National Authorities; CEIC; AMRO staff calculations

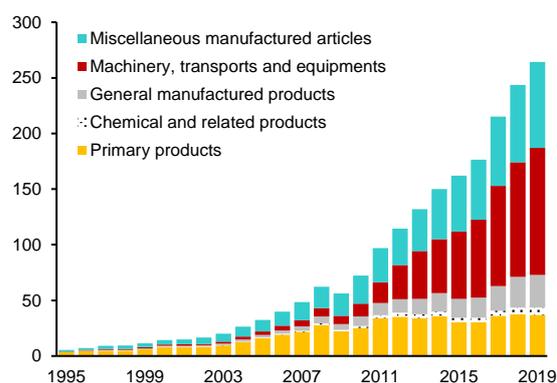
Note: Calculations involving GDP are based on the recently revised GDP data for 2010-17 and AMRO staff's GDP estimates from 2018 onwards.

## Annexes: Selected Issues

### 1. Evolution of Vietnam's Exports and Global Value Chain (GVC) Participation<sup>45</sup>

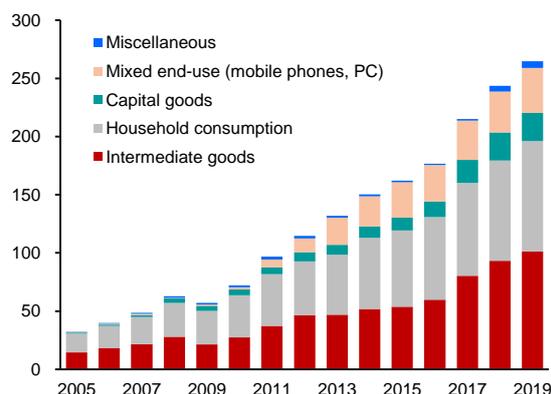
**1. Vietnam's exports have diversified and grown exponentially over the past two decades.** Vietnam's gross exports of goods reached USD264.2 billion in 2019, a 48-times increase in 25 years from USD5.5 billion in 1995 when it joined ASEAN (Figure A1.1). During these two decades, Vietnam's exports have become more diversified and sophisticated.<sup>46</sup> In the 1990s through the first half of 2000s, primary products, such as food and mineral fuels, accounted for more than half of total exports. From the early 2000s, miscellaneous manufactured goods—such as textiles and clothing—began to increase their contribution to Vietnam's exports. And since 2013, the share of machinery, transports and equipment—in particular mobile devices—in total exports, has grown exponentially and exceeded other manufactured and primary products. In terms of end-use, Vietnam's exports comprise mainly intermediate goods and final consumption goods, while mixed end-use and capital goods have grown in prominence recently (Figure A1.2).

**Figure A1.1 Exports of Goods by Product, 1995-2019**  
(Billions of USD)



Source: GSO  
Note: Based on SITC (Standard International Trade Classification).

**Figure A1.2 Exports of Goods by End-Use, 2005-2019**  
(Billions of USD)



Source: GSO; OECD STAN (Structural Analysis) Database

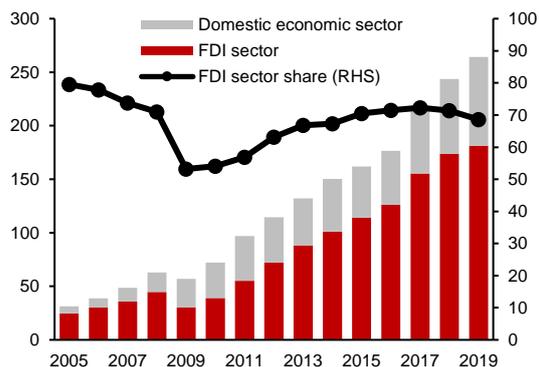
**2. Foreign direct investments (FDI) have played an important role in the rapid growth of exports (Figure A1.3).** Since Samsung Electronics' large investments in Bac Ninh in 2007, Vietnam has emerged as a major final assembly hub for ICT hardware and electronic-related products. According to World Bank Group (2017), about 80 percent of electronics/ ICT hardware and over 30 percent of electronic-related products produced in Vietnam are destined for export markets, and are mostly manufactured by foreign

<sup>45</sup> This selected issue was prepared by Jinho Choi.

<sup>46</sup> ADB's Multi-Regional Input-output (MRIO) database also confirmed this transition. Vietnam's low technology manufacturing jumped from 30.7 percent in 2000 to 50.3 percent of gross exports of goods and services in 2017, comprising food, beverages and tobacco (20.7 percent of gross exports), textiles and textiles products (11.7 percent), and leather and footwear (8.6 percent). High and medium technology manufacturing has increased five-fold from 4.1 percent in 2000 to 20.8 percent, led by electrical and optical equipment (12.2 percent). In contrast, the percent contribution of primary goods declined substantially from 42.1 percent in 2000 to 11.9 percent in 2017.

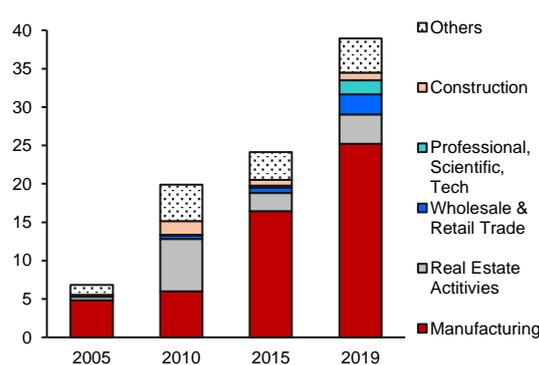
firms. Growing attention to Vietnam as a production base has led to strong FDI inflows, particularly in the manufacturing sector. Additionally, FDI into higher value-added non-manufacturing sectors has increased recently too, in particular in professional, scientific and technical activities, which will help improve Vietnam’s business environment and total factor productivity going forward (Figure A1.4).

**Figure A1.3 Exports of Goods by Type of Ownership**  
(Billions of USD; Percent)



Source: GSO via Haver Analytics; AMRO staff calculations

**Figure A1.4 Registered FDI Capital by Economic Activity**  
(Billions of USD)



Source: GSO via CEIC

**3. The decomposition of Vietnam’s gross exports in terms of sources of value added shows the dynamic nature of GVC participation.** As multi-country production sharing arrangements have become a new norm in international trade, a simple summary of gross exports data is insufficient to understand key strengths and weaknesses of a country’s export structure. In this regard, the gross exports accounting framework proposed by Wang, Wei, and Zhu (2018) provides a useful toolkit to quantify how much of the value added embedded in Vietnam’s gross exports are explained by domestic or foreign production factors. Applying this methodology to the ADB MRIO database covering the period 2000 and 2007-2017<sup>47</sup>, Vietnam’s gross exports can be decomposed into two major categories – domestic value-added (DVA) and vertical specialization (Box A1. Gross Exports Decomposition Methodology). Vertical specialization comprises foreign value-added (FVA) and pure double counted items (PDC), the latter of which reflect ‘back-and-forth’ trades in intermediate goods involved in multiple cross-border production sharing arrangements, or more complex GVC activities.

<sup>47</sup> As of 23 November 2020, ADB MRIO database’s annual input-output tables are published up to 2019 on its website (<https://mrio.adbx.online/>). However, due to some data breaks observed in Vietnam’s 2018-19 tables, this analysis uses the input-output data tables only up to 2017.

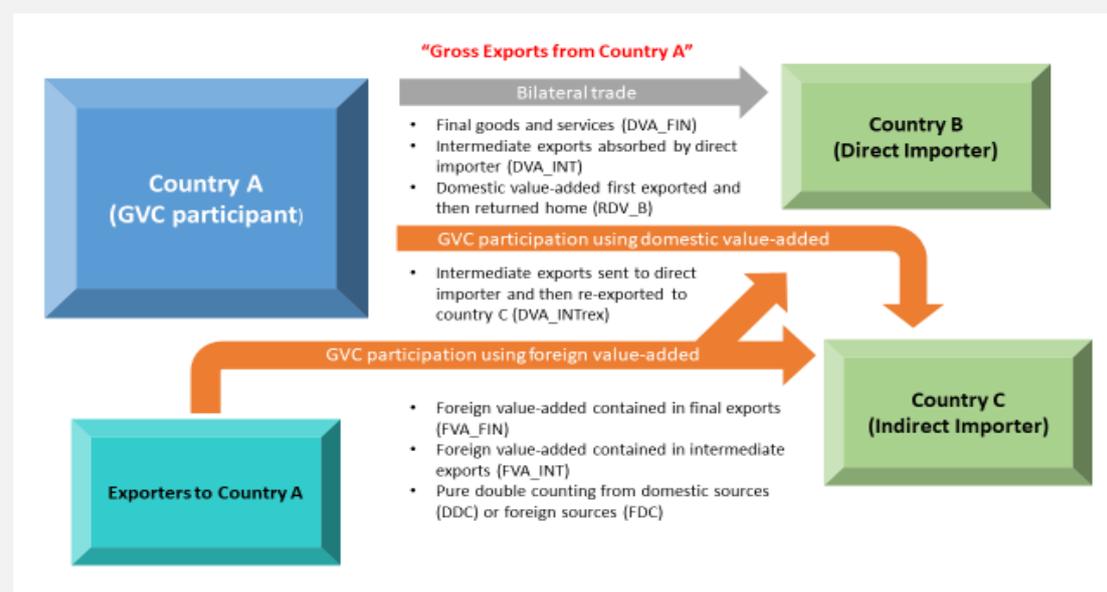
### Box A1. Gross Exports Decomposition Methodology

Wang, Wei, and Zhu (2018) provides a systematic way of decomposing a country's gross exports in value-added terms from a GVC participation perspective: 1) bilateral trade components not engaged in GVC participation; 2) domestic value-added (DVA) contributions to GVC participation; and 3) foreign value-added (FVA) contributions to GVC network via vertical specialization (Figure A1).

More specifically, DVA consists of two components: DVA absorbed abroad (VAX\_G) and DVA first exported and then returned home (RDV\_B). The former can be further decomposed into: (i) DVA in final use commodity exports (DVA\_FIN); (ii) DVA in intermediate exports used by direct importer to produce its domestic final use commodities and consumed there (DVA\_INT); and (iii) DVA in intermediates sent to the first importer and then re-exported to a third country (DVA\_INTrex). Among DVA components, only DVA\_INTrex is counted as contributing to GVC network via re-exports from a direct importer.

Meanwhile, vertical specialization comprises FVA and pure double counted items (PDC), both contributing to the economy's GVC participation. FVA can be further decomposed into: (i) FVA embedded in final use commodity exports (FVA\_FIN); and (ii) FVA embedded in intermediate exports (FVA\_INT).

Figure A1. Decomposition of Gross Exports in Value-added Terms



Source: AMRO

Note: Based on Wang, Wei and Zhu (2018) methodology.

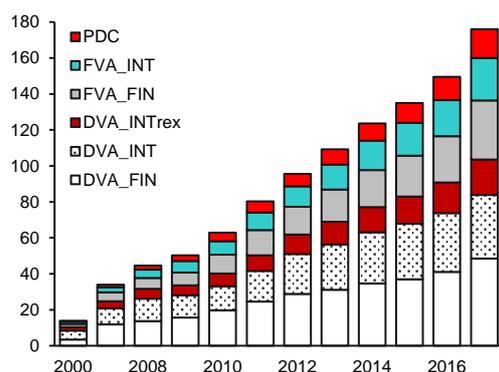
**4. Value-added decomposition of Vietnam's exports shows increasing vertical specialization over the past decades.** Figure A1.5 indicates that all value-added components—DVA, FVA and PDC—have expanded over the past two decades in tandem with gross exports. Some of the key findings are as follows:

- The intensity of Vietnam's forward GVC participation, measured by DVA\_INTrex (the part of DVA embedded in its intermediate exports that were re-exported to a third country), remained at about 11 percent during 2007-2017. By industry, both

the low- and the high- and medium-manufacturing sectors have seen a modest increase in the intensity of forward GVC participation in this period (Figure A1.6).

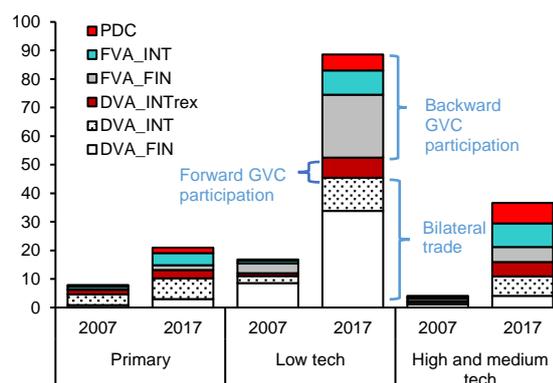
- The intensity of Vietnam’s backward GVC participation (the contribution of FVA to gross exports) has increased from 23 percent in 2007 to 32 percent in 2017. For the low technology manufacturing sector, the contribution of FVA has jumped from 26 percent to 34 percent, while the sector’s exports increased by five times. The high- and medium-technology sector has also benefited from rising FVA, whose contribution to the sectoral gross exports rose from 33 percent in 2007 to 37 percent in 2017.
- The rising contribution of PDC to gross exports indicates that the share of Vietnam’s value-added in its exports that cross borders multiple times has increased. This phenomenon is commonly observed across industries, suggesting that Vietnam’s cross-border production sharing activities have intensified.

**Figure A1.5 Value-Added Decomposition of Gross Exports**  
(Billions of USD)



Source: ADB-MRIO Database (accessed on 16 September 2020); AMRO staff calculations

**Figure A1.6 Value-Added Decomposition of Gross Exports by Manufacturers, 2007 vs 2017**  
(Billions of USD)



Source: ADB-MRIO Database (accessed on 16 September 2020); AMRO staff calculations.

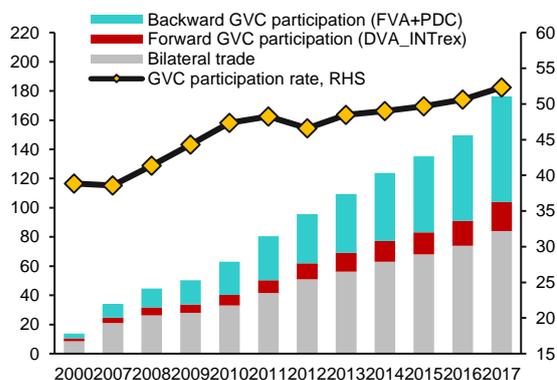
**5. Vietnam’s GVC participation has strengthened, driven mainly by backward GVC participation.** Vietnam’s GVC participation rate<sup>48</sup> increased significantly from 38.6 percent in 2007 to 52.3 percent in 2017 (Figure A1.7). Among the manufacturing industries, the GVC network of the high- and medium-technology sector exhibits the highest participation rate at 70.1 percent in 2017, as a result of a more balanced combination of domestically sourced (DVA\_INT, DVA\_FIN) and foreign sourced (FVA\_INT, FVA\_FIN) value-added components, as well as ‘back-and-forth’ intermediate trades (PDC) (Figures A1.6 and A1.8). The low-technology sector has seen a surge in the GVC participation rate from 34.2 percent to 48.6 percent in this period, with a high reliance on foreign-sourced value-added in final goods exports. The primary sector has also intensified GVC participation, which is mainly attributable to foreign-sourced value-

<sup>48</sup> A country’s GVC participation is often measured as the ratio of the sum of forward (DVA\_INTrex) and backward GVC participation (FVA\_INT + FVA\_FIN + PDC) to gross exports, following Hummels et al. (2001) and Aslam et al. (2017). In principle, PDC, which consists of domestically sourced (DDC) and foreign sourced (FDC) components, can contribute to both forward and backward GVC participation. In the case of Vietnam, as DDC remains negligible, PDC is considered as contributing to backward GVC participation.

added in intermediate exports, while intermediate exports of domestic value-added goods are still significant in 2017.

**Figure A1.7 Breakdown of Gross Exports by GVC Participation**

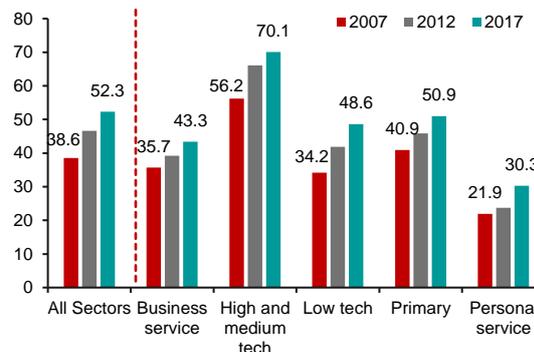
(Billions of USD; Percent of Gross Exports)



Source: ADB-MRIO Database (accessed on 16 September 2020); AMRO staff calculations

**Figure A1.8 GVC Participation by Broad Sector**

(Percent of Gross Exports)

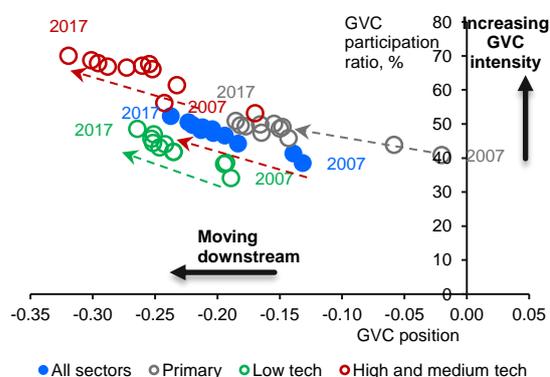


Source: ADB-MRIO Database (accessed on 16 September 2020); AMRO staff calculations

**6. Vietnam's GVC participation has been moving toward more downstream products, while concentrating on simple GVC-related activities.** Figure A1.9 shows the shifting pattern of Vietnam's GVC participation and relative position<sup>49</sup> over the past decade. Vietnam has moved more downstream while intensifying its GVC participation. By industry, the shift to downstream in GVC network is most significant in the high- and medium-technology sector, followed by the low-technology sector, and then the primary sector. Meanwhile, in terms of GVC complexity, Vietnam's participation has been mainly in simple GVCs (involving only a one-time border crossing for production), which accounts for about 65 percent of total GVC production activities in 2017 (Figure A1.10).

**Figure A1.9 GVC Participation and Position, 2007 vs 2017**

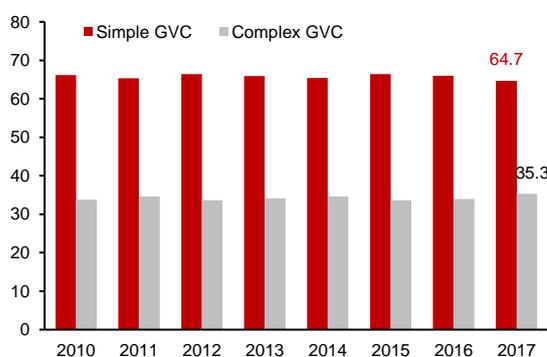
(Index; Percent of Gross Exports)



Source: ADB-MRIO Database (accessed on 16 September 2020); AMRO staff calculations

**Figure A1.10 Simple versus Complex GVC as a Share of Total GVC Production Activities**

(Percent)



Source: ADB-MRIO Database; AMRO staff calculations

<sup>49</sup> The relative position of Vietnam's exports in the value chain is assessed based on Koopman et al. (2014). Vietnam's GVC position index is constructed by the log ratio of its forward participation share to the backward participation share, i.e.  $GVC\ position\ index = \ln(1 + DVA\_INTrex / Gross\ Exports) - \ln(1 + (FVA\_INT + FVA\_FIN + PDC) / Gross\ Exports)$ .

**7. Vietnam has been successfully transformed into a manufacturing-oriented economy, supported by stronger GVC participation over the past decade.** More than half of Vietnam's gross exports in value-added terms were involved in GVC networks in 2017 via either direct or indirect channels, mainly led by low-technology manufacturers. Vietnam has been able to position itself as a final assembly hub using foreign-sourced intermediate inputs. However, its involvement in more complex GVC manufacturing activities has been limited. Moving forward, the rise in new competitors among low-income economies may trigger FDI firms' relocations and weaken Vietnam's current GVC position which is specialized in simple, downstream GVC activities. Vietnam, therefore, needs to upgrade its participation in GVCs by moving up the technological ladder into the production of more complex intermediate products.

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## 2. FDI as a Driver of Economic Growth<sup>50</sup>

**1. Understanding FDI's contribution to economic growth is essential to assessing Vietnam's economic achievements and limitations.** Given that Vietnam has been one of the most active players in the GVC network, analyzing Vietnam's inward FDI as one of the key economic growth drivers helps assess its economic achievements over the past decade. In particular, analyzing the dynamic impact of capital stock and other production inputs on Vietnam's long-term growth potential can provide a good basis for assessing its economic achievements and constraints.

**2. Vietnam's potential output and the factor contributions are estimated via the growth accounting method to assess the role of investment in its economic growth.** Vietnam's potential output is estimated over the period from 1986 to 2019, using a human capital-augmented production function.

$$Y_t = A_t K_t^\alpha (L_t H_t)^{1-\alpha}$$

$$H_t = \exp(\varphi S_t)$$

Where  $Y_t$  represents GDP in year  $t$ ,  $K_t$  the physical capital stock,  $L_t$  the labor component,  $H_t$  the human capital per worker,  $\alpha$  the income share of capital, and  $A_t$  the total factor productivity, calculated as a Solow residual. Human capital  $H_t$  is defined as a function of  $S_t$  average years of schooling in year  $t$ , and  $\varphi$  the return to education.

- Physical capital stock, based on the perpetual inventory method, and employment data are constructed from the Penn World Tables 9.1 Database.
- The labor income share ( $1 - \alpha$ ) is assumed to be 0.44, using the 2004-2017 average of the ILO estimates for Vietnam.
- Data on years of schooling and return to education<sup>51</sup> are constructed from the latest extension of Barro and Lee's (2013) database and Psacharopoulos and Patrinos (2004, 2018), respectively.

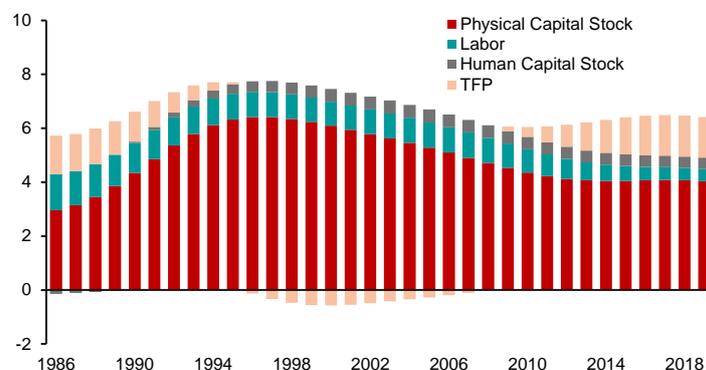
**3. Decomposition of Vietnam's potential output growth suggests that physical capital stock has been a dominant driver of its rapid economic growth.** Vietnam's potential growth rates had gradually moderated from the 7-8 percent range in 1990s to about 6 percent in 2009-10, before edging up to 6.5 percent in 2015-19 (Figure A2.1). Although the exact magnitude of the estimates may vary to some extent depending on the methodology used, such as trend-filtering method, choices of proxy variables for factor inputs and the like, the result has generally confirmed that physical capital stock accumulation has contributed the most to Vietnam's economic growth over the past decades and although its contribution has declined in recent decades, it still accounts for about two-third of potential output growth. Meanwhile, the contributions of both labor input and human capital stock to potential growth have remained relatively modest. In

<sup>50</sup> This selected issue was prepared by Jinho Choi.

<sup>51</sup> In the literature on human capital, returns to investment in education have been estimated as regression coefficients on years of schooling in determining earnings under various model specifications such as ordinary least squares (OLS) and instrumental variable (IV). See comprehensive surveys of Psacharopoulos and Patrinos (2004, 2018) for details.

contrast, the contribution of total factor productivity (TFP) has increased significantly since 2010, when the influx of FDI accelerated.

**Figure A2.1 Vietnam's Potential Growth Estimates**  
(Percent yoy)

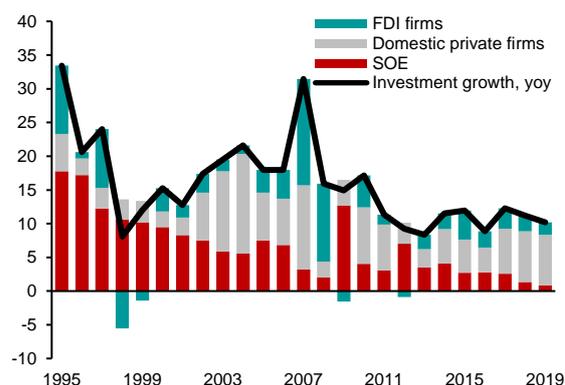


Source: AMRO staff estimates.

### Physical Capital Stock

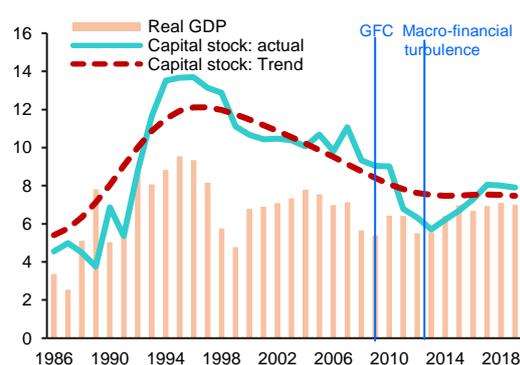
**4. Initially led by state-owned enterprises (SOEs), Vietnam's physical capital investment has been increasingly driven by non-SOE private enterprises.** Since the early 2000s, domestic private firms and FDI firms have increased their contributions to Vietnam's capital stock accumulation while contributions from SOEs have declined (Figure A2.2). In the aftermath of the Global Financial Crisis and the macro-financial turbulence during 2011-12 triggered by a sharp increase in NPLs, capital stock growth dropped to 5.7 percent in 2013, followed by a moderate recovery to 8 percent in 2017, leading to a strong pick-up in GDP growth (Figure A2.3).

**Figure A2.2 Investment Growth by Ownership**  
(Percent yoy)



Source: GSO via CEIC

**Figure A2.3 Physical Capital Stock Growth**  
(Percent yoy)

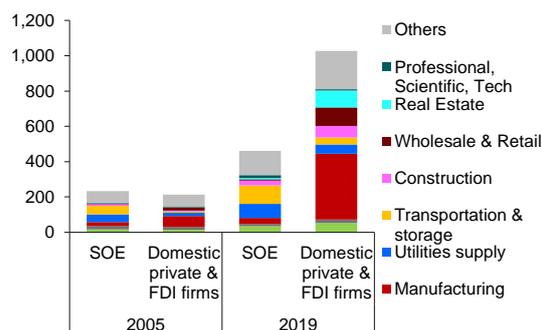


Source: GSO; Penn World Tables 9.1.; AMRO staff estimates

**5. Capital stock accumulation by domestic private firms has been increasing but their profitability remains low.** Investments made by SOE and non-SOE sectors are distinct in terms of key investment areas and profitability. As quasi-government agencies, SOEs have mainly undertaken infrastructure-related investments such as utilities, and

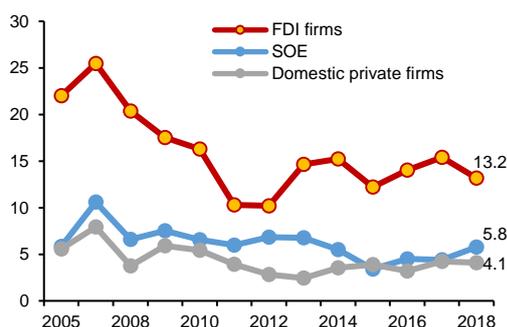
transportation and storage. Meanwhile, investments made by domestic private firms and FDI firms are concentrated in manufacturing, trade and real estate activities (Figure A2.4). In terms of investment efficiency, FDI firms continue to outperform SOEs and domestic private firms, with their average returns on assets and long-term investment (13.2 percent in 2018) more than twice those of SOEs (5.8 percent) and domestic private firms (4.1 percent), partly reflecting the fact that FDI and SOE firms have focused on different industrial sectors (Figure A2.5).

**Figure A2.4 Investment by Economic Activity**  
(Trillions of VND, constant 2010 prices)



Source: GSO via CEIC

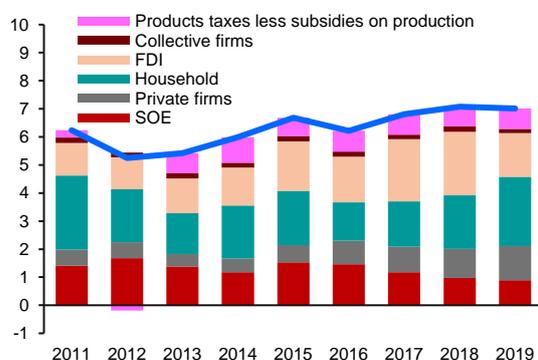
**Figure A2.5 Return on Fixed Assets and Long-Term Investment by Firm Ownership**  
(Percent)



Source: GSO via CEIC; AMRO staff calculations  
Note: Based on profit before tax/ fixed asset and long-term investment.

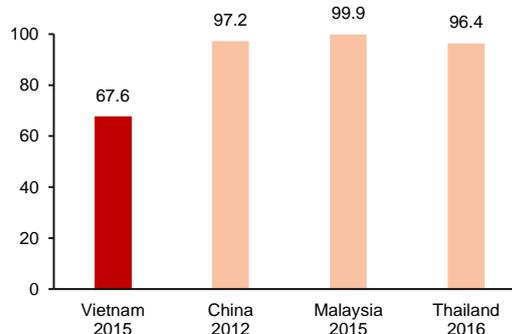
**6. The contribution of the domestic private sector to economic growth has risen significantly in the last several years.** In 2019, the private sector contributed about 49 percent to the country's real GDP (excluding product taxes less subsidies), of which 35 percent was from households—which run micro/small businesses—and only 10 percent from domestic private firms and 4 percent from collective businesses. The share of SOEs has fallen from 33 percent of GDP in 2011 to 29 percent of GDP in 2019, lower than that of domestic private sector. Meanwhile, FDI firms' contribution to GDP has gradually increased from 18 percent in 2011 to 22 percent in 2019 (Figure A2.6). While Vietnamese private firms may benefit from strengthening linkages with FDI firms, the spillover effects of FDI on domestic manufacturing capacity seem still limited (Figure A2.7).

**Figure A2.6 Real GDP by Ownership**  
(Percent yoy)



Source: GSO; AMRO staff calculations

**Figure A2.7 Proportion of FDI Firms using Domestic Inputs**  
(Percent)

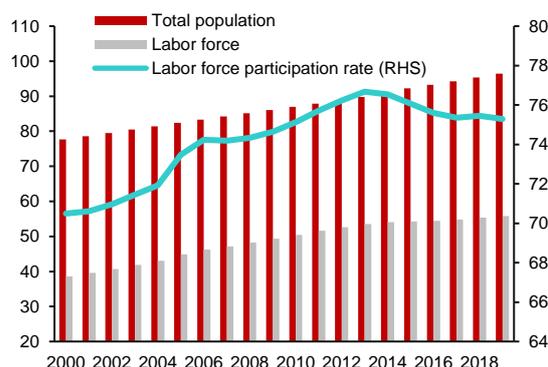


Source: World Bank Group (2017)

## Human Capital Stock

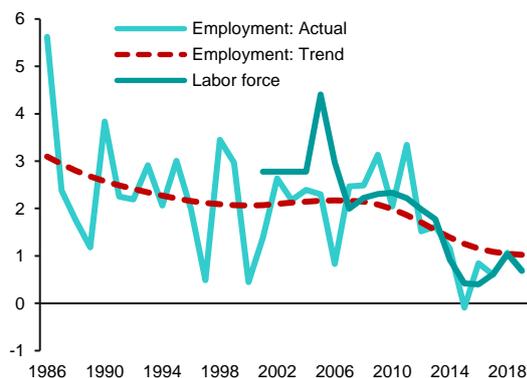
**7. The supply of labor has slowed recently, moderating employment growth.** Vietnam’s total population has been growing steadily at slightly above 1 percent per annum in the past two decades, and its labor force participation rate remains high at around 75 percent in 2019. However, such favorable demographic dynamics which allowed ample labor supply in the past are changing gradually. The growth of the labor force has plateaued, and the labor force participation rate has been moderating from its peak of 76.7 percent in 2013 (Figure A2.8). Additionally, slower growth in the labor force has led to a slowdown in employment growth in recent years (Figure A2.9) despite Vietnam’s low unemployment rate, which is hovering at around 2 percent. By type of enterprise, non-state sectors—including households and domestic private firms—remain the dominant employers, accounting for 84 percent of total employment in 2019. Supported by strong FDI inflows, the number of workers hired by FDI firms has been growing while employment in SOEs has declined. Taking into account the fact that FDI firms tend to be (and are increasingly more) capital intensive and the government has been promoting SOE equitization/ divestment, the domestic private sector has to be further enhanced to provide more quality jobs in higher value-added sectors.

**Figure A2.8 Labor Force Participation**  
(Million persons; Percent)



Source: GSO via Haver Analytics; AMRO staff calculations  
Note: The labor force participation rate indicates the percentage share of labor force among the population aged 15 and above.

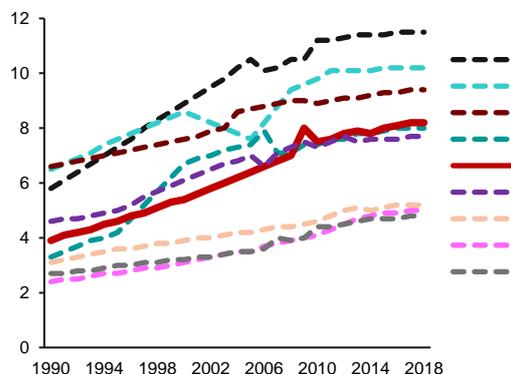
**Figure A2.9 Growth in Labor Force and Employment**  
(Percent yoy)



Source: GSO; Penn World Tables 9.1.; AMRO staff estimates

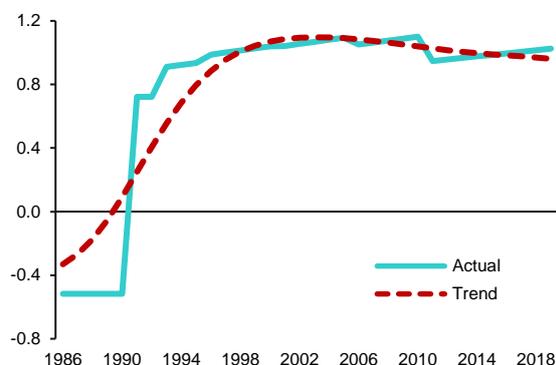
**8. The quality of Vietnam’s labor force has improved substantially with faster accumulation of human capital stock.** One of Vietnam’s key strengths has been its ample supply of young and relatively skilled labor. Vietnamese students are known for their consistently outstanding performances in the International Student Assessment (PISA) test since they first started participating in 2012. Moreover, with Vietnam’s continuing strong emphasis on education, its average years of schooling has doubled from 4.1 years in 1990 to 8.2 years in 2019 (Figure A2.10), which is reflected in a rapid accumulation of human capital stock estimates (Figure A2.11).

**Figure A2.10 Average Years of Schooling**  
(Years)



Source: UNDP; Barro and Lee (2018)

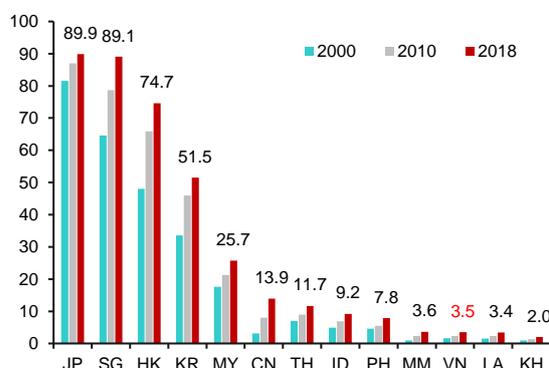
**Figure A2.11 Human Capital Stock Growth**  
(Percent yoy)



Source: GSO; Penn World Tables 9.1.; Barro and Lee (2018) Database; AMRO staff estimates  
Note: 'Actual' indicates the growth rate of human capital per worker, measured as the product of average years of schooling and return on education.

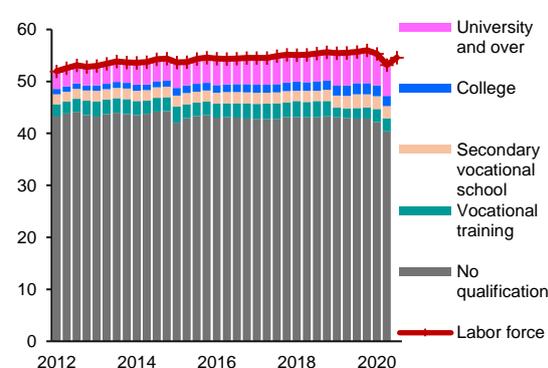
**9. However, Vietnam still has a long way to catch up with the regional peers in labor productivity.** Progress in educational attainment has helped Vietnam's labor productivity grow annually by 5.2 percent on average between 2010-2018, according to the latest World Bank's estimates (World Bank Group, 2020). However, labor productivity in Vietnam, measured by output per worker, is still ranked among the lowest in the ASEAN+3 region in 2018, although this indicator should be used cautiously for cross-country comparisons, as it is less favorable to countries with strong labor-intensive industries (Figure A2.12). Despite the increase in average years of schooling and strong performance in PISA test, as of Q2 2020, about 76 percent of the labor force still has no professional qualification or technical skills needed for employment (Figure A2.13). In addition, the tertiary education institutions, including universities and technical and vocational schools, are not adept in providing the skills needed in the job market (Kataoka et al., 2020).

**Figure A2.12 Labor Productivity, Output Per Worker**  
(Thousands of 2010 USD)



Source: World Bank Group (2020, Global Productivity Trends)

**Figure A2.13 Labor Force by Professional and Technical Qualification**  
(Million persons)

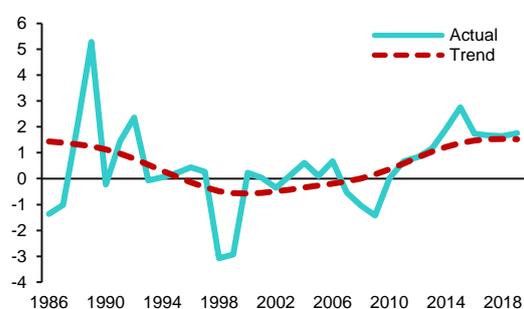


Source: GSO via Haver Analytics

### Total Factor Productivity (TFP)

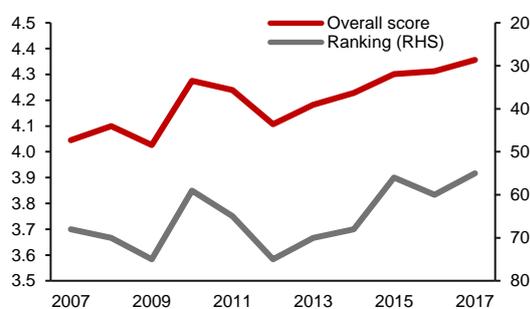
**10. Global competitiveness indicators confirm the advances in Vietnam’s TFP.** The potential growth contribution estimates show that TFP’s growth contribution has increased significantly since the early 2010s in tandem with increased FDI inflows (Figure A2.14). TFP is usually understood as how efficiently measurable production input factors—labor and capital—are combined to generate a country’s output. Since it cannot be observed or measured directly, some indirect measures are often used as a proxy for TFP, such as country competitiveness indicators. Vietnam’s performance in the global competitiveness index (GCI) published by the World Economic Forum has been improving since 2012 both in terms of its overall score as well as global ranking (Figure A2.15).

**Figure A2.14 Total Factor Productivity Growth**  
(Percent yoy)



Source: AMRO staff estimates

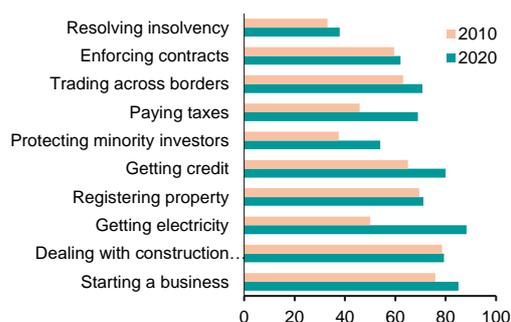
**Figure A2.15 Vietnam: Global Competitiveness Index**  
(Score 1-7 [best]; Ranking)



Source: World Economic Forum

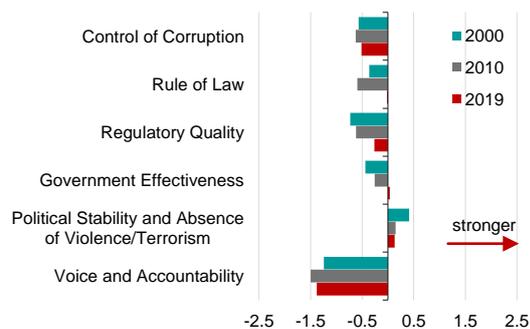
**11. Despite significant improvements in the overall business environment, Vietnam’s institutional upgrading remains slow.** Vietnam’s overall ease of doing business has improved significantly, with strong advances in tax administration, local financing and electricity supply. In contrast, some institutional indicators show very slow improvements, such as resolving insolvencies and enforcing contracts (Figure A2.16). Similarly, the World Bank’s Worldwide Governance Indicators suggest that Vietnam’s overall governance—consisting of the traditions and institutions by which the authority is exercised (Kaufmann et al., 2010)—has more room for improvement in order to boost TFP growth (Figure A2.17).

**Figure A2.16 Ease of Doing Business by Category, 2020**  
(Score 1-5 [best])



Source: World Bank

**Figure A2.17 Worldwide Governance Indicators, 2020**  
(Score -2.5 to +2.5 [strongest])



Source: World Bank

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