

Viet Nam

Strong exports and domestic demand pushed GDP growth higher in 2018 than in more than a decade. Inflation was stable, and the current account surplus widened. This year and next, though, a weaker external environment will likely moderate growth and narrow the current account surplus, while inflation remains stable in 2019 but rises somewhat in 2020. Small and medium-sized enterprises need to upgrade their capacity to benefit from better integration into global value chains.

Economic performance

The economy experienced another year of strong growth as it accelerated from 6.8% in 2017 to 7.1% in 2018, the highest in 11 years. Solid growth in exports of goods and services and continued strength in domestic demand underpinned last year's expansion. Private consumption, the largest component of GDP, accounted for most of GDP growth last year (Figure 3.31.1).

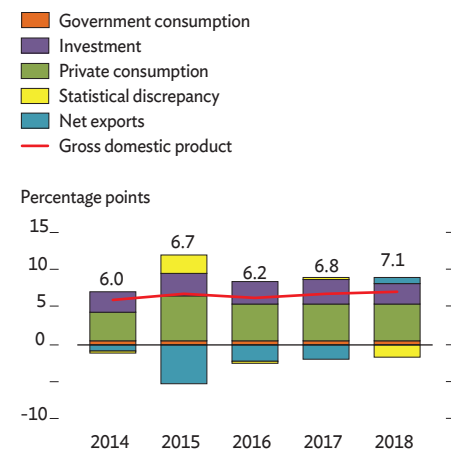
Although growth in exports of goods and services moderated from 16.7% in 2017 to 14.3% last year, net exports expanded by 9.2%. Strong external demand thus gave a big boost to Viet Nam's highly trade-dependent economy. Merchandise exports rose by 13.8%, with exports of telephones and accessories, which now account for a fifth of merchandise exports, rising by 11.0%.

Domestic demand held up well, though moderating from 7.3% in 2017 to 7.2% last year. Rising incomes and stable inflation underpinned a strong rise in private consumption. Growth in gross investment slowed from 9.8% in 2017 to 8.2%. Buoyant foreign direct investment (FDI) was up by 9.1% in 2018, and investment from the state budget rose by 12.5% (Figure 3.31.2).

By sector, growth in agriculture, industry, and construction accelerated while growth in services moderated. Agriculture and agribusiness improved on 2.9% expansion in 2017 with growth at 3.8% last year. Fisheries were the best performer within the sector, achieving 6.5% growth. More broadly, agriculture profited from recent government initiatives to update farm technology.

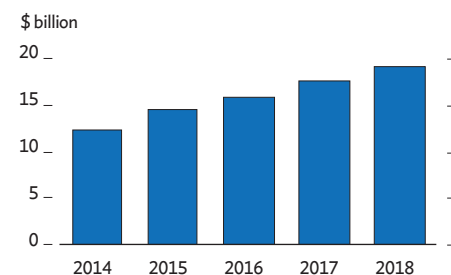
Benefiting from strong export orders and domestic demand, growth in industrial production accelerated from 7.8% in 2017 to 8.8% last year, with construction,

3.31.1 Demand-side contributions to GDP growth



Source: General Statistics Office of Viet Nam.

3.31.2 Disbursement of foreign direct investment



Sources: General Statistics Office of Viet Nam; State Bank of Viet Nam.

up by 8.7% in 2017, improving to 9.2% growth. Industry and construction contributed nearly half of GDP growth last year with improved mining output and continued momentum in manufacturing driven by increases in the export-oriented sectors: telecommunications, electronics, and textiles. Growth in services moderated from 7.4% in 2017 to 7.0%, with wholesale and retail trade the strongest segment, up by 8.5%. International tourist arrivals rose by a fifth (Figure 3.31.3).

Encouragingly, stronger growth did not cause much inflationary pressure. Inflation averaged 3.5% in 2018, as in 2017 and below the official target of 4.0% (Figure 3.31.4). Core inflation averaged 1.5%, little changed from the previous year. While higher costs for medical services, education, and transportation contributed to inflationary pressure in the first 10 months of the year, pressure was eased by a decline in international oil prices, the government's decision to postpone a planned hike in electricity tariffs, and tighter monetary conditions.

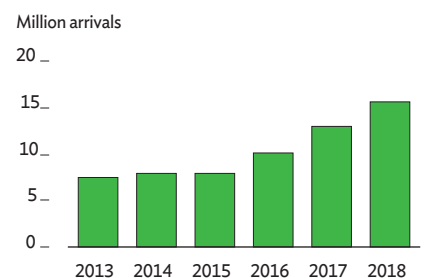
The external position strengthened. The current account continued to post a surplus, up from the equivalent of 2.9% of GDP in 2017 to an estimated 3.0%, supported by a \$7 billion trade surplus and stable service receipts. Sizeable FDI and portfolio capital inflows pushed the estimated surplus in the capital account to the equivalent of 6.0% of GDP. Data from the General Statistics Office show that registered foreign investment reached \$35.5 billion in 2018, including an estimated \$25.5 billion in new FDI commitments. Inflows of foreign equity investment reached an estimated \$10 billion, reflecting positive sentiment among foreign investors.

Surpluses in the current and capital accounts added up to an overall balance of payments surplus estimated to equal 5% of GDP. The strengthened external position improved foreign reserves from a low 2.7 months of import cover at the end of 2017 to an estimated 3.0 months a year later.

Budgetary expenditure growth was sharply down from 17.1% in 2017 to an estimated 10.5% last year. Growth in current expenditure slowed from 11.6% in 2017 to 8.7% as discretionary spending was contained. Budget revenue growth slowed from 11.9% in 2017 to 9.6% in 2018. The on-budget fiscal deficit expanded marginally from the equivalent of 3.5% of GDP in 2017 to an estimated 3.7% (Figure 3.31.5). Strong economic growth helped the government to contain public debt at the equivalent of 61.4% of GDP at the end of 2018, down from its peak of 63.7% in 2016 and comfortably below the statutory cap of 65.0%.

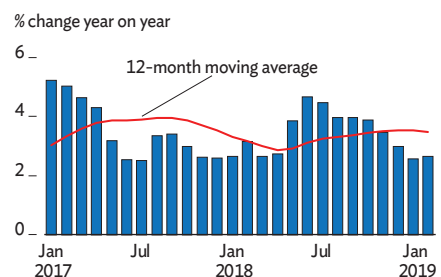
Inflationary pressures eased at year-end, but as they built in the first 10 months of 2018, growth in credit and the money supply (M2) was controlled with stricter limits applied on commercial banks' credit growth and stricter regulations on lending in high-risk areas such as real estate and securities.

3.31.3 Tourist arrivals



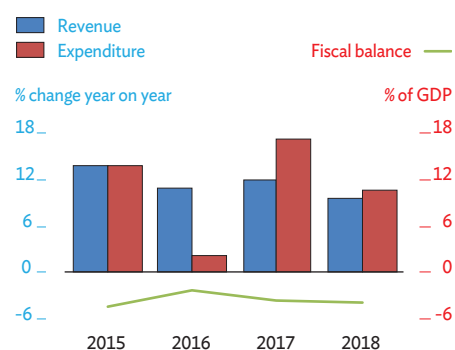
Source: General Statistics Office of Viet Nam.

3.31.4 Monthly inflation



Source: General Statistics Office of Viet Nam.

3.31.5 Fiscal balance



Note: Data exclude off-budget spending and on-lending.

Source: Ministry of Finance.

Estimated growth in credit was contained at 14.0% and in money supply at 12.0%, the lowest growth for both since 2015 (Figure 3.31.6). Despite volatility in international financial markets, the Viet Nam dong stabilized against the US dollar, depreciating by only 1.8% in the whole year (Figure 3.31.7).

Economic prospects

With growth in the global economy and world trade forecast to slow, growth in Viet Nam is forecast to moderate but remain strong at 6.8% in 2019 and 6.7% in 2020 (Figure 3.31.8). Growth will continue to be broad-based, underpinned by export-oriented manufacturing, inward FDI, and sustained domestic demand.

Ongoing reform to improve the business environment should encourage private investment, as should efforts to forge stronger ties with partners around the world through various trade agreements. Viet Nam's ratification of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership in 2018, and its expected free trade agreement with the European Union, may stimulate investment in the near term as foreign enterprises explore the expanding business opportunities that Viet Nam offers.

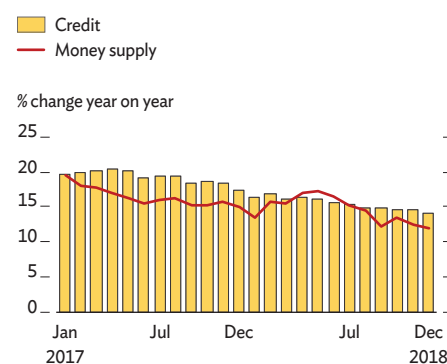
These trade agreements signify the government's continued commitment to liberalizing the economy. The government targets the establishment of 140,000 new businesses in 2019, which bodes well for exports, FDI inflows, and private investment more generally. The outlook for private consumption remains robust as households enjoy rising incomes and stable inflation. Investment should find support in accelerated public capital expenditure this year and next to meet the target of the country's 2016–2020 socioeconomic development plan.

By sector, manufacturing and construction will slow but still maintain solid expansion, with substantial FDI likely to flow into export-orientated manufacturing. The purchasing managers' index points to rising orders in manufacturing (Figure 3.31.9). Services will benefit in 2019 from continued growth in retail and wholesale trade, and in banking and finance. An expected 16.0% annual increase in tourist arrivals this year and next, though slowing from growth in 2018, should support tourism-related businesses such as hotels, restaurants, and transportation. Meanwhile, agriculture will likely expand at near the government's target of 3.0% per year.

Inflation is expected to continue to average 3.5% in 2019 but accelerate to 3.8% in 2020 (Figure 3.31.10).

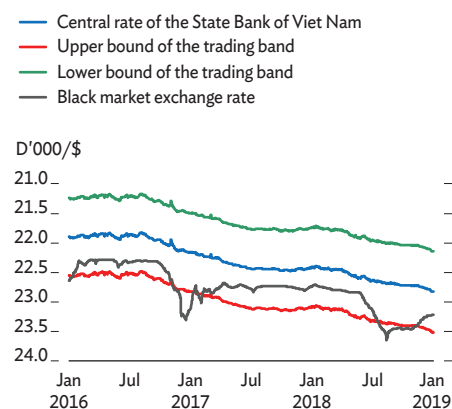
The announcement that the US Federal Reserve will no longer raise its policy rate in 2019 is likely to relieve pressure on the Viet Nam dong and inflation, as will lower international oil prices. Upward adjustments to administered fees for public

3.31.6 Growth in credit and money supply



Sources: State Bank of Viet Nam; ADB estimates.

3.31.7 Exchange rates



Sources: State Bank of Viet Nam; ADB observations.

3.31.1 Selected economic indicators (%)

	2019	2020
GDP growth	6.8	6.7
Inflation	3.5	3.8
Current account balance (share of GDP)	2.5	2.0

Source: ADB estimates.

education, health care, and electricity may add to inflationary pressures, however, as may a higher minimum wage.

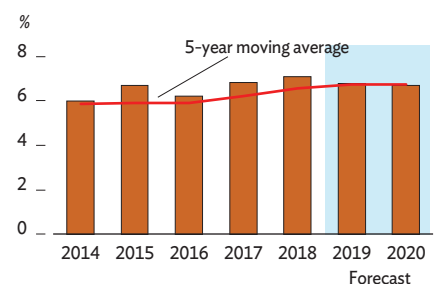
The current account surplus is expected to narrow to the equivalent of 2.5% of GDP this year and 2.0% in 2020 as exports decelerate under softening global demand but imports slow less because of robust domestic consumption and investment. Remittances may also suffer from slower global growth. If trade tensions between the People's Republic of China (PRC) and the US drag on, Viet Nam may benefit as trade and production shift from the PRC to its regional neighbors, with as much as 2.0% of GDP accruing over the medium to long term, mostly beyond the forecast horizon.

The government will continue to pursue fiscal consolidation even as it supports growth. It targets holding the fiscal deficit to the equivalent of 3.6% of GDP this year and reducing it in 2020. To spur investment and support economic growth, the 2019 budget plans to raise capital expenditure by 7.4%. Current expenditure is set to rise by 7.2%.

With slower GDP growth and stricter control of credit in high-risk areas such as real estate, credit growth will likely be contained in 2019 below last year's 14.0%. The resolution of banks' nonperforming loans is expected to continue in 2019 and 2020. Nonperforming loans—including those warehoused at the Viet Nam Assets Management Company and other problem loans not yet classified as nonperforming—are to be reduced to below 5% of banks' outstanding loan portfolio in 2019 and to 3% in 2020. This should make the banking sector more stable and efficient, as should Viet Nam's implementation of Basel II standards and its easing of restrictions on foreign ownership of banks.

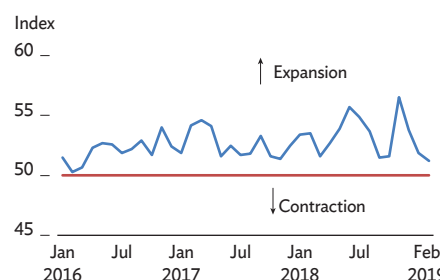
An external risk to the outlook would be a sharper slowdown in the major economies, including the European Union, the US, Japan, and the PRC, Viet Nam's key trade partners. Domestic risks could stem from lackluster progress in reforming state-owned enterprises. The equitization of state-owned enterprises in 2018 fell far short of the government's target of at least 85 enterprises. The establishment of the Committee for Management of State Capital in 2018 is expected to ensure that the use of state capital is more effective so that conflicts that arise from the state having dual roles as owner and regulator are minimized. By leveling the playing field for the private sector and reducing market distortion, the government hopes to encourage more private enterprise.

3.31.8 GDP growth



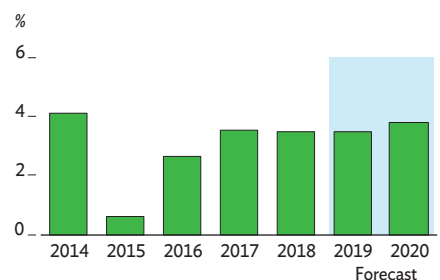
Source: Asian Development Outlook database.

3.31.9 Purchasing managers' index



Note: Nikkei, Markit.
Source: Bloomberg.

3.31.10 Inflation



Source: Asian Development Outlook database.

Policy challenge—integrating private firms into global value chains

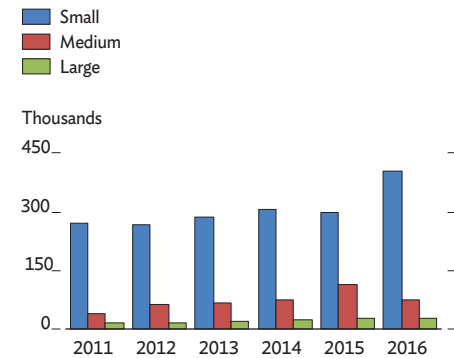
Since the beginning of economic reform in 1986, Viet Nam has rapidly integrated with the global economy. The value of all trade to and from Viet Nam is now twice its GDP, and FDI inflow in 2018 equaled 8% of GDP. Viet Nam is a signatory to 12 free trade agreements that integrate the economy into global value chains (GVCs). However, participation in GVCs has been driven largely by foreign-owned firms. Domestic private firms in Viet Nam are predominantly small and medium-sized enterprises (SMEs). In 2017, more than half a million domestic SMEs contributed nearly half of GDP, but hardly any participated in GVCs (Figure 3.31.11).

The uneven quality of products and services offered by domestic SMEs is the main constraint on their integration into GVCs. This is particularly problematic as international markets tighten their technical, quarantine, environmental, and health standards. SMEs have little access to new technologies that would help them overcome these barriers. A World Bank Enterprise Survey found that SMEs in Viet Nam approached product innovation primarily as a way to reduce costs, not to improve product quality. In addition, few SMEs purchase or license newer technologies developed elsewhere.

Indeed, SMEs in Viet Nam suffer many constraints. Their capacity to purchase and adapt newer technologies is restricted by limited access to finance and a shortage of workers with the necessary skills. Affordable financing is often out of reach because of banks' stringent collateral requirements and complicated procedures, and because capital markets are insufficient, despite the existence of multiple mechanisms to provide finance to SMEs: the SME Development Fund, commercial banks, credit guarantee funds, and the Viet Nam Development Bank, among others. Regarding the shortage of skills, a recent survey by ManpowerGroup showed that only 11% of firms in Viet Nam can provide the skills required for GVC participation. Yet the “low cost, low skills” era of Viet Nam's development is over, and Viet Nam must become a higher-skilled economy.

To address the underlining causes of uneven product quality, policy should encourage and support the adoption of new technology and, eventually, domestic innovation. SMEs need credit for purchasing and leasing capital equipment and new technologies. Developing the necessary skills requires comprehensive and integrated solutions that bring together governments, schools, and the private sector to provide technical and vocation training that responds to demand. Without better access to finance and skills, SMEs will continue to lag in their integration into GVCs.

3.31.11 Number of enterprises, 2011–2016



Source: Enterprise Census 2017, General Statistics Office of Viet Nam.

