

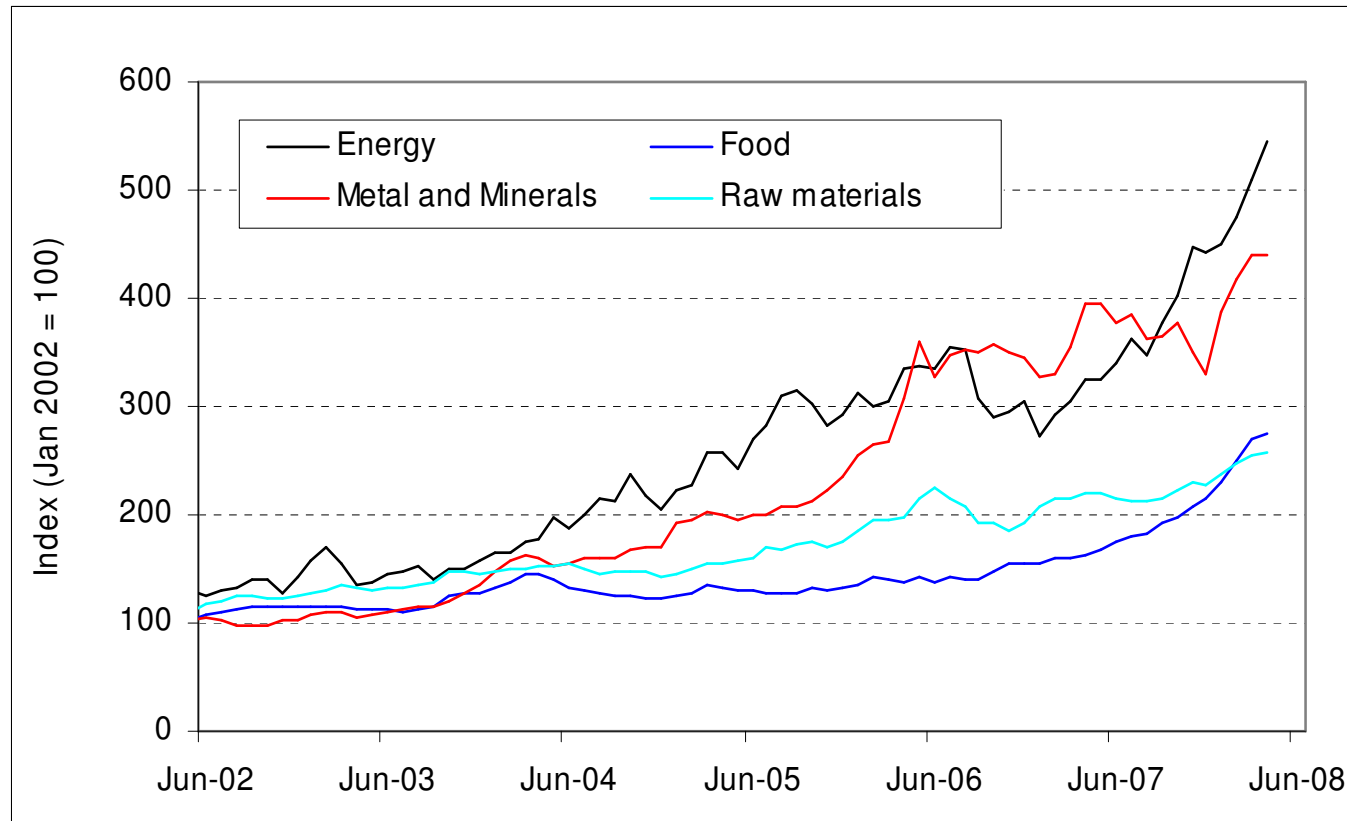
# Taking Stock

An Update on Vietnam's  
Recent Economic Developments

The World Bank in Vietnam  
June 5-6, 2008

# A more uncertain global environment

## World commodity price index

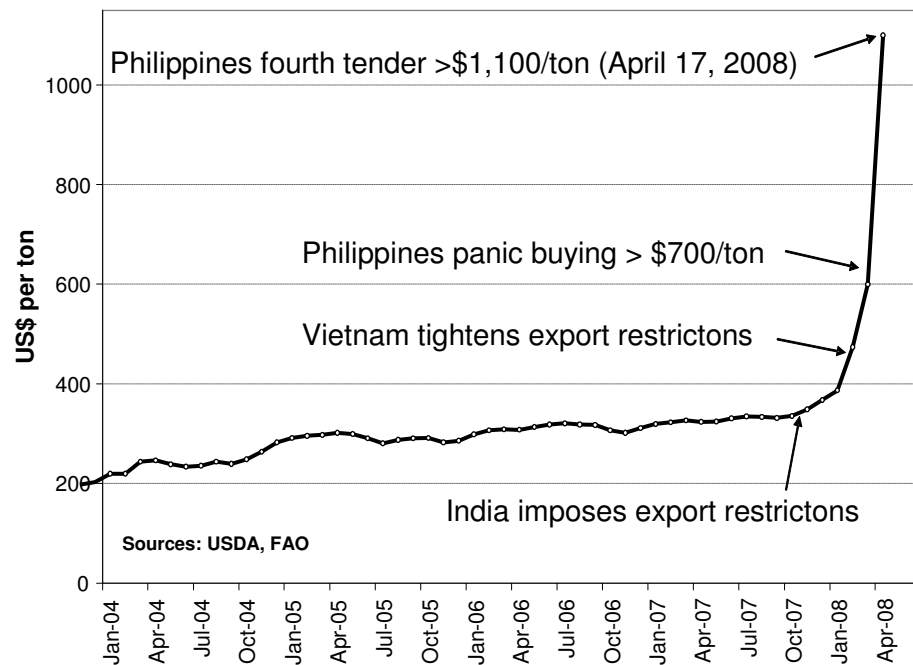


Source: World Bank

The biggest uncertainty concerns financial markets.

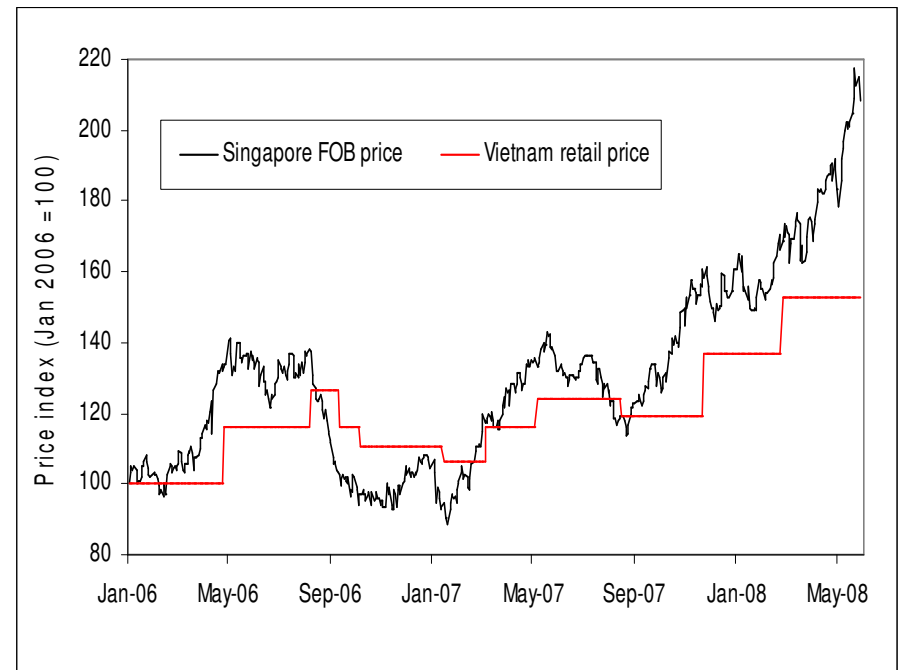
# Pressure from higher world prices

Rice prices in domestic and world markets



Source: Based on data from USDA, FAO and GSO

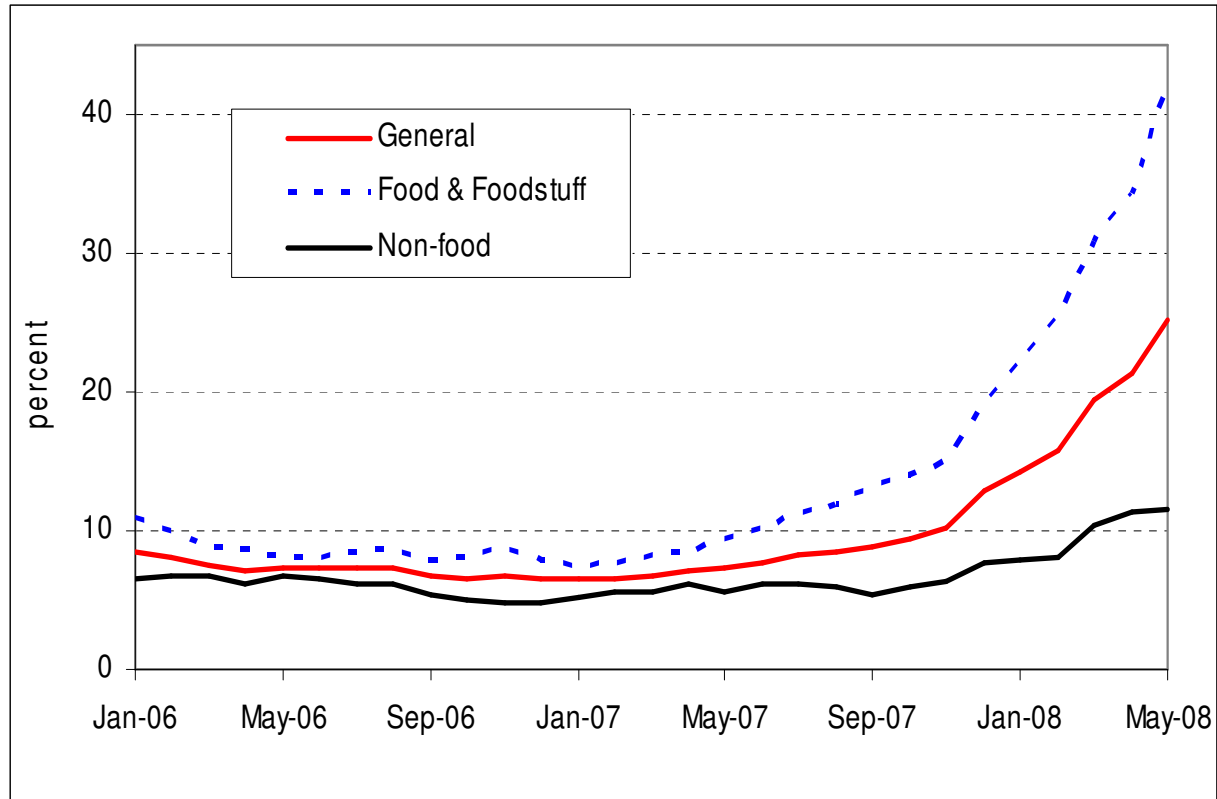
Gasoline prices in domestic and world markets



Source: Singapore FOB price is based on the US Department of Energy

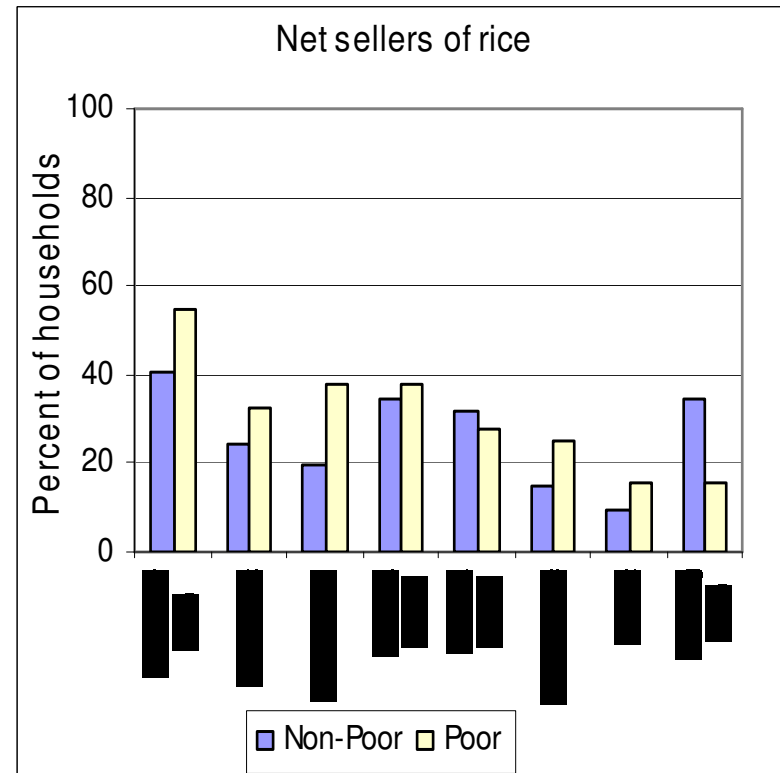
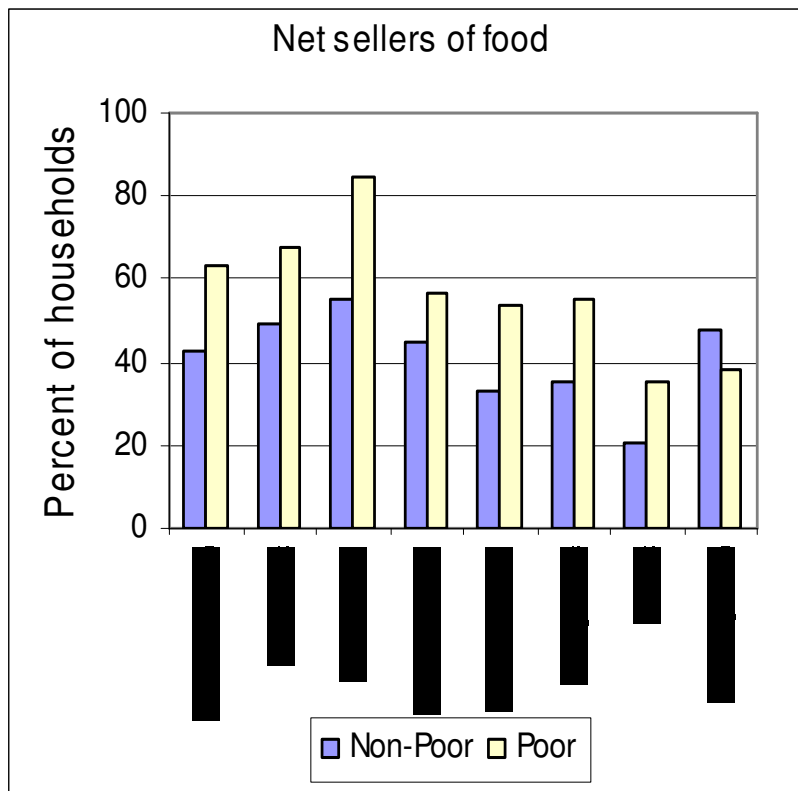
Domestic prices lag behind and will have to be adjusted

# Inflation accelerates



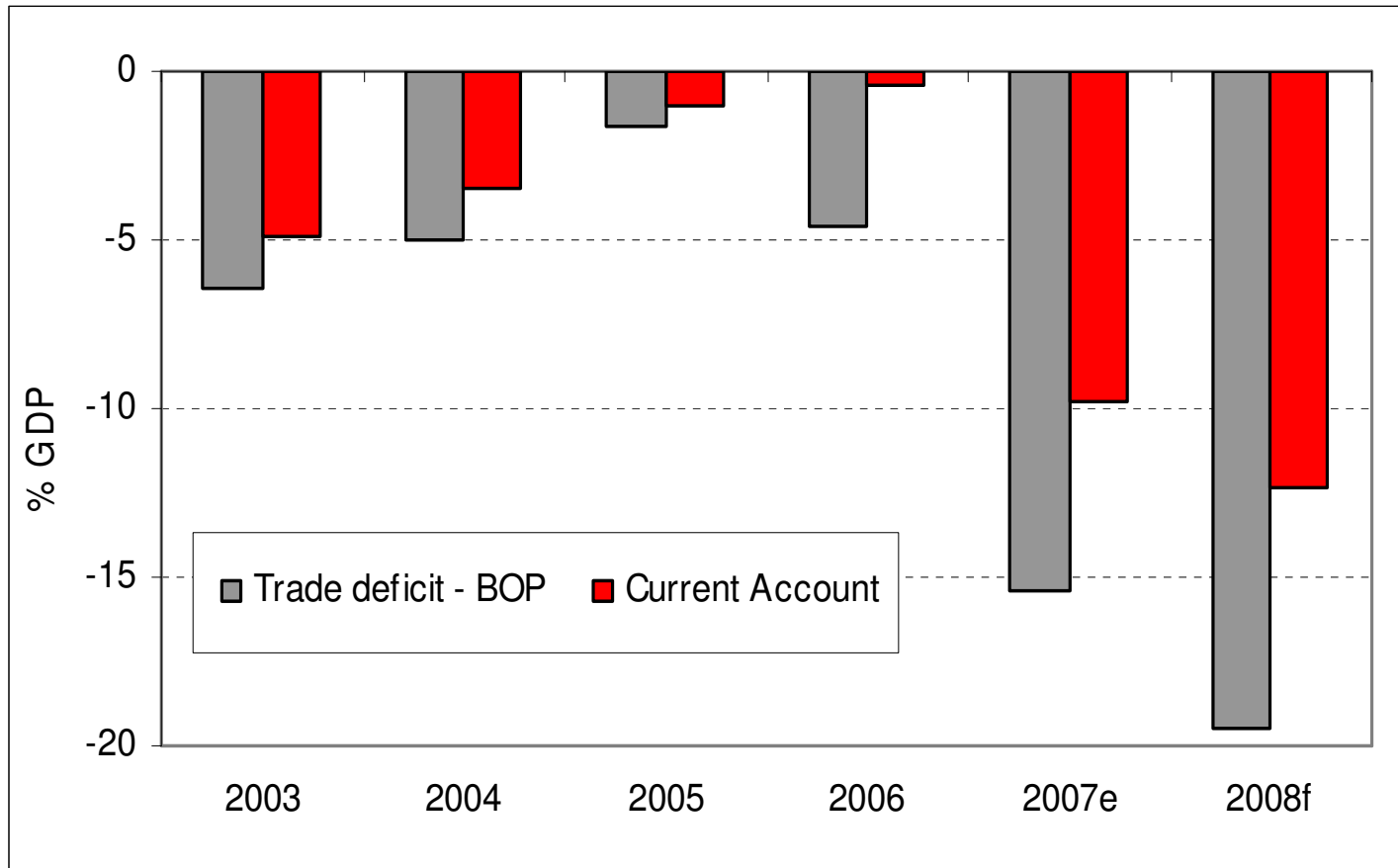
Mainly driven by higher food prices. But non-food inflation has risen too, and the causes are domestic

# Social impact of higher prices



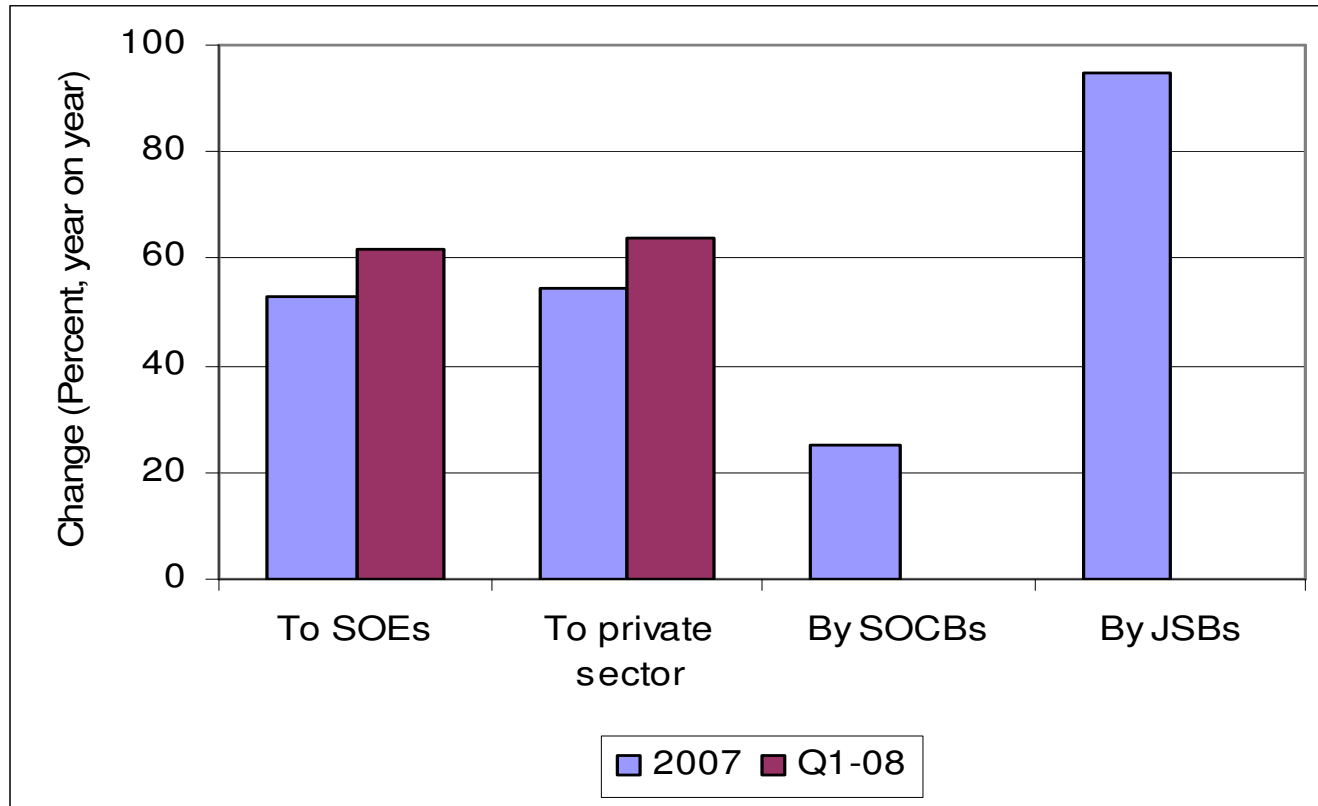
On average, Vietnamese households are net producers of food and rice; so higher prices increase welfare on average. But higher prices of rice mean that the majority loses.

# Current account deficit widens



# The causes of the overheating

## Credit growth and its components

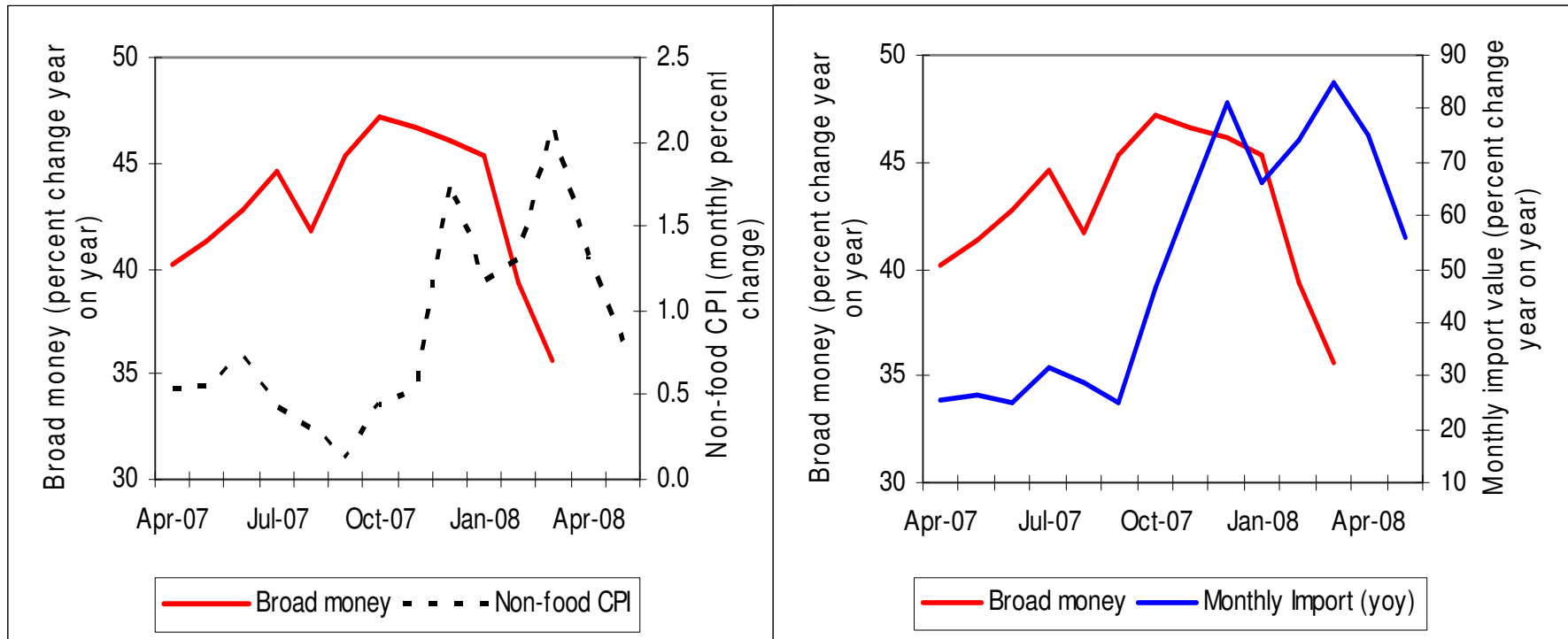


Economic Groups and General Corporations contributed to asset price frenzy in 2007, through investments in financial and real estate businesses. However, the main cause was rapid credit growth, especially by JSBs.

# The policy response and its implementation

1. Priority to controlling inflation
2. Credit growth target for 2008: 30 percent
3. Tighten government expenditures
4. Revise public expenditure investment plan
5. More flexible exchange rate
6. Accept lower growth in 2008: 7 percent

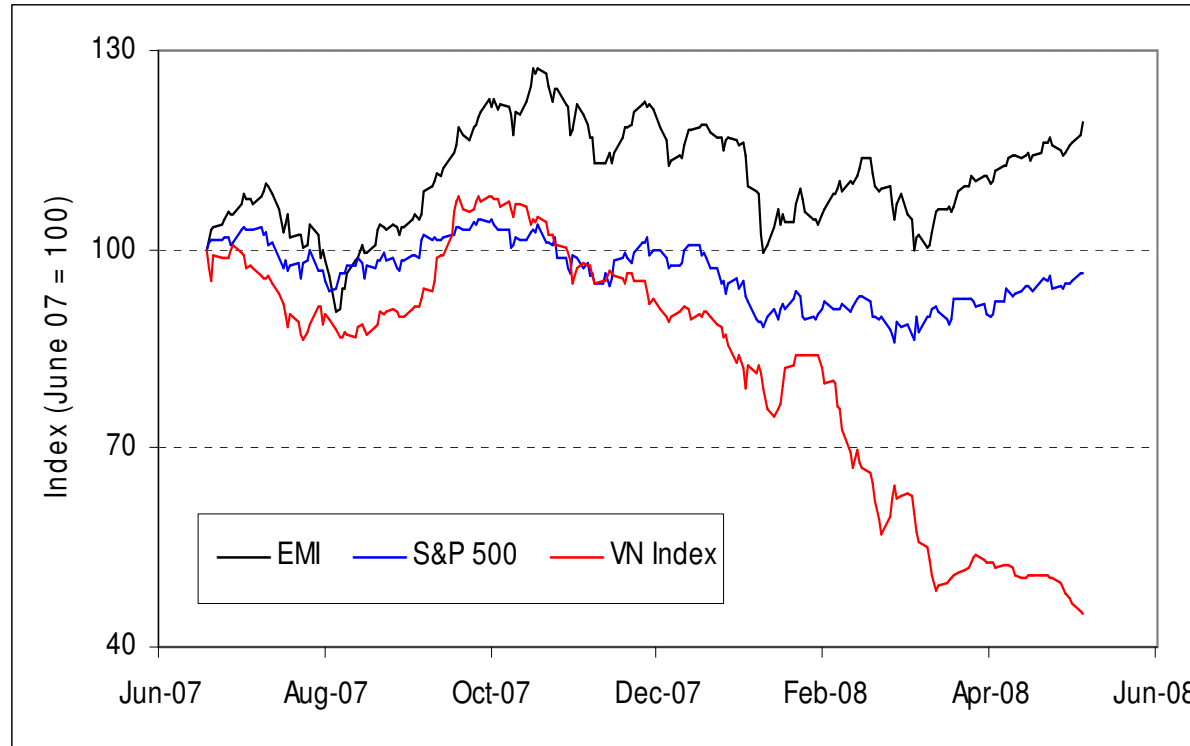
# Is it working? (1)



Source: Based on data from SBV and GSO

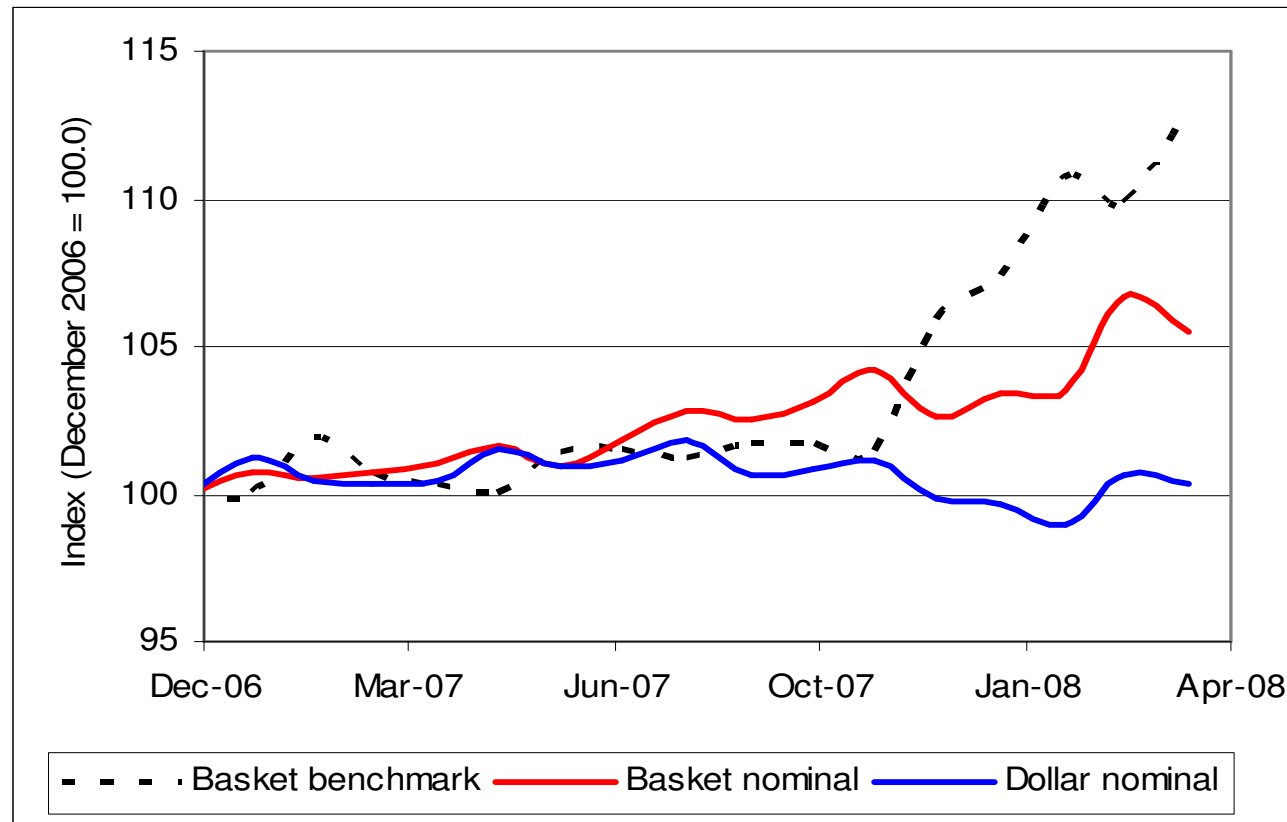
The contraction in money supply seems to have an effect on non-food inflation and on the growth rate of imports, with a lag of about three months

# Is it working? (2)



But the contraction is also bringing down the price of assets. This affects the banks who got over-exposed to the real estate market.

# Exchange rate policy



The acceleration of inflation in Vietnam has resulted in real appreciation (a decline in competitiveness). The trade deficit and weaker inflows call for depreciation

# Main Recommendations (1)

- Stabilization policies are working, even if this is hidden by time lags and high world prices of food
- The government should therefore continue the implementation of its credit policy.
- However, more could be done on fiscal policy and exchange rate policy.
- If all the burden of adjustment falls on credit policy the weakest banks will be vulnerable.
- And it will take time for asset markets to recover, affecting economic activity and equitization plans

# Main Recommendations (2)

- More decisive action is needed in relation to public investment projects and government spending
- It is also necessary to gradually raise the reference exchange rate and widen the flotation band.
- This would help restore the trade balance and dissuade fears about exchange rate corrections.
- Even with these measures in place, priority should be given to financial sector stability.
- Having weak banks quickly absorbed by stronger ones will preserve depositor confidence

# 2008: Targets and Forecasts

- Even with all these measures in place, inflation is bound to remain high
- World prices of food and gasoline are higher than in Vietnam, and they will need to catch up
- At present, a move towards greater exchange rate flexibility will result in some devaluation of the dong
- In an open economy, devaluation raises the prices of all goods that can be imported or exported.
- However, due to the “inertia” of the economy, the growth rate of GDP may remain quite high

# Is the World Bank too Optimistic?

