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Macroeconomic Stabilization in Vietnam: Recent Experiences and Lessons

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Introduction

Since the *Doi Moi* (*Renovation*) in 1986, Vietnam has embarked simultaneously on domestic market-oriented reforms, international economic integration and maintaining macroeconomic stability. While international economic integration and domestic reforms broadened the economic opportunities for the people, enhanced macroeconomic stability helped provide the right market-based signal for efficient resource allocation. In general, this laid grounds for numerous socio-economic achievements.

In particular, the years of 2001-2010 have seen fundamental changes in the macroeconomic situation. Specifically, there were two main groups of external factors affecting Vietnam's economic development, namely: (i) international economic integration attempts (BTA with the US, WTO accession, etc.); and (ii) external shocks (SARS; global financial crisis and economic recession in 2008-2009; high oil prices in 2007 and early 2008; rapid hike in food prices in 2008, etc.). These external factors interact with the inherent aspects, including strengths and weaknesses, of the economy as well as policy adjustments.

The years 2001-2006 marks a period of expansion for Vietnam's economy. Economic growth was rather high, reaching 7.5% p.a. on average in 2001-2005 and 8.2% in 2006. From the supply side, the growth rate was mainly induced by industry-construction sector. Export growth was rapid and continuous, averaging at 18.4% p.a. in 2001-2006. Investment also rose from 35.4% of GDP in 2001 to 41.5% GDP in 2006. FDI began to flow in, while the private sector flourished. Trade deficit tended to increase, but remained small relative to GDP. Meanwhile, inflation was controlled at one-digit level, despite soaring in the years 2004 and 2005.

Since 2007, after acquiring membership of the WTO (and deepening efforts for FTA-based regional economic integration), the economy has been facing larger uncertainty in the world economic environment. A surge in FDI inflows until 2008 not properly addressed by the State Bank of Vietnam (SBV) - together with inflationary pressures built up from a long period of growth-induced credit and investment expansion - led to high inflation in 2008. This necessitated comprehensive attempts of the Government to control inflation. In late 2008, however, the global economic recession following the global financial crisis appeared to trigger economic downturn in Vietnam. Consequently, Vietnam had to ease monetary policy and to implement a stimulus package for preventing domestic economic downturn. As the root causes of inflation in 2008 were not thoroughly addressed, the macroeconomic environment started to show signs of instability again in late 2010 - after economic growth somewhat recovered. This gave rise to the Resolution 11/NQ-CP (hereinafter referred to as Resolution 11) in February 2011 for macroeconomic stabilization.

In the years 2007-2010, therefore, Vietnam's economic performance exhibited larger volatility. Economic growth became slower, averaging only 7.0% per annum. The roles of

[1] The views and opinions expressed in this paper are solely of the author and may not necessarily reflect those of the CIEM.

the private and foreign-invested sectors increased further, while the State economy contracted in relative terms. Except in 2009 with the global economic recession, export growth has been positive, attaining 16.0% per annum on average. Investment continued to increase, but gradually became too large relative to both GDP and domestic savings. The ratio of investment over GDP peaked at 46.5% in 2007 and reached an average of 43.2% in 2007-2010. Trade deficit went up considerably, amounting to 16.2% of GDP on average. Year-on-year inflation went up until August 2008, and fluctuated drastically in 2009-2010 before rising again in 2011.

As an interesting observation, Vietnam still has to encounter high inflation and its unfavourable impacts on socio-economic development, notwithstanding the successful attempts in addressing much more serious inflationary issues in late 1980s and early 1990s. This paper attempts to look into the pattern of inflation and related policy responses after the WTO accession. In doing so, the paper focuses specifically on the two sub-periods: (i) from late 2007 to 2008; *and* (ii) from late 2010 to 2011. At the same time, the paper draws references to Vietnam's macroeconomic developments which constitute the context for inflation control. On that basis, the paper briefly lists some key lessons for controlling inflation from Vietnam's recent experiences.

Apart from the Introduction, the remainder of this paper is structured as follows. Section 1 provides an overview of Vietnam's macroeconomic performance in 2007-2010. Section 2 then analyzes inflationary development in the sub-period from late 2007 to 2008, with due focus on the policy responses undertaken by the Government. Section 3 follows with an elaboration of mounting inflation and efforts made under the Resolution 11. Section 4 concludes with some key lessons drawn from Vietnam's attempts for inflation control in the analyzed sub-periods.

1. Macroeconomic performance

This sub-section looks at the economic performance on Vietnam in terms of merchandise trade, investment, growth, inflation, and balance of payments.

Merchandise Trade

After the WTO accession, Vietnam successfully made further use of comparative advantages for promoting export. The value of merchandise exports went up from USD 48.6 billion in 2007 to USD 62.9 billion in 2008, then fell to USD 56.6 billion in 2009. Notably, merchandise exports started to fall for the first time since the 4th quarter of 2008 due to the impact of global financial crisis which led to a substantial reduction of commodity and oil prices as well as aggregate demand. In fact, the export growth rate in the first 3 quarters of 2008 reached about 39%, but those for the 4th quarter of 2008 and the first 3 quarters of 2009 were 6.4% and -14.3%, respectively. Vietnam's merchandise export began to perform better in the 4th quarter of 2009, thereby restricting the fall in export for 2009 as a whole to 9.7%. Merchandise export then went up again to USD 72.2 billion in 2010, and already reached USD 51.5 billion in the first 7 months of 2011, reflecting year-on-year growth rates of 26.4% and 33.5%, respectively.

The corresponding changes in Vietnam's merchandise imports were of greater magnitude than those of merchandise export. Total merchandise import[2] in 2008 reached USD 80.4 billion or grew by 28.3%. However, such a growth rate was slower than that in 2007 (39.6%), because of the economic slowdown and the measures for restricting trade deficit since 2007. In 2009, merchandise import even went down to USD 68.8 billion, reflecting a decrease by 14.7%. The growth recovery then led to increase in import which reached USD 84.8 billion in 2010 and USD 58.1 billion the first 7 months of 2011. Nonetheless, the trade deficit remained large, peaking at USD 18.0 billion in 2008 before falling continuously to USD 12.6 billion in 2010. Notably, this resulted largely from trade deficits with China, ASEAN, and Korea, which were mainly driven by trade deficit of intermediate goods (Truong Dinh Tuyen *et al* 2011).

Investment

In recent years, Vietnam's total investment tends to fall in terms of overall GDP. The investment ratio, measured by total investment over GDP, decreased from 46.5% in 2007 to 41.5% in 2008, 42.7% in 2009, and 41.9% in 2010. In the years 2007-2009, investment (at comparable prices) rose by almost 14.8% per annum on average. As the salient feature of investment in Vietnam, the State investment accounts for a large share of total investment. However, the share of State investment declined continuously and drastically from 45.7% in 2006 to 33.9% in 2008, respectively, before rising again to 40.6% in 2009 and 38.1% in 2010 (Table 1).

Table 1: Investment structure by ownership (%; 2006-2010)

	2006	*2007*	*2008*	*2009*	*2010*
State sector	45.7	37.2	33.9	40.6	38.1
Domestic non-State sector	38.1	38.5	35.2	33.9	36.1
Foreign-invested sector	16.2	24.3	30.9	25.5	25.8
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Central Institute for Economic Management (CIEM; 2011).

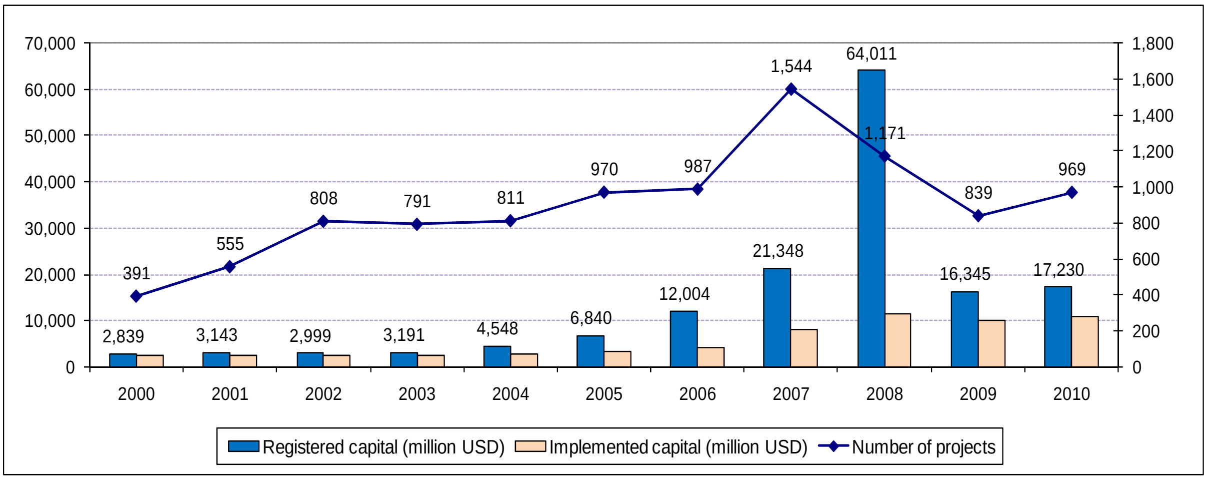
The figure decreased significantly in 2008 due to the tightening of State investments and stricter domestic credits. Its dramatic increase in 2009 stemmed largely from the implementation of the stimulus package. Meanwhile, the share of FDI in total investment increased from 16.2% in 2006 to 30.9% in 2008, and dropped to 25.8% in 2010. Conversely, the share of domestic non-State sector dropped from 38.1% in 2006 to 33.9% in 2009, after which it recovered to 36.1% in 2010. Thus, the investment structure exhibited a significant shift. Notwithstanding its dominance, the gap between State investment and investment from other sources was narrowed.

Following the WTO accession, Vietnam further portrays itself as a promising destination for FDI. FDI inflows to the country went up considerably, particularly to services and real estate sectors. In 2008, about USD 64 billion of FDI was registered, and the implemented and disbursed FDI already amounted to USD 11.5 billion and about USD 8.3 billion, respectively (Figure). In 2009, however, FDI flows into Vietnam decreased to USD

[2] Measured at CIF prices, unless otherwise specified

16.3 billion and USD 10.0 billion for registered and implemented capital, respectively. The figures for registered and implemented capital remained largely unchanged in 2010, reaching USD 17.2 billion and USD 11.0 billion, respectively.

Figure 1: FDI in Vietnam, 2000-2010

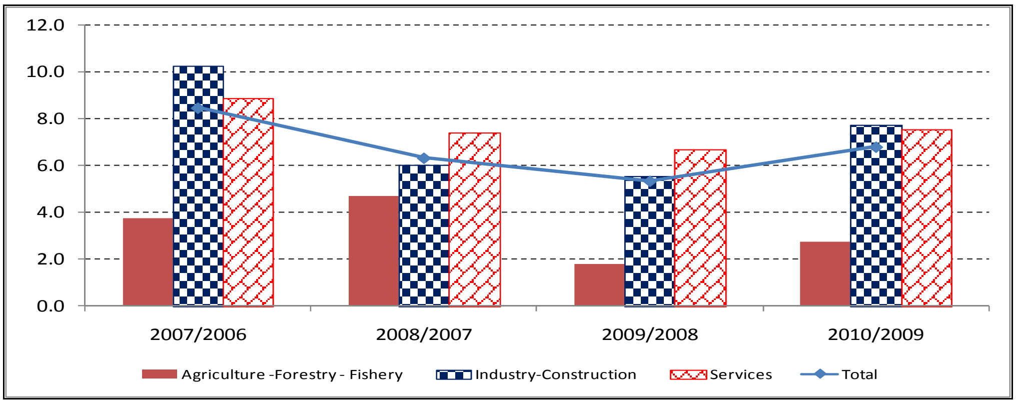


Source: Ministry of Planning and Investment (MPI).

Economic growth

Notwithstanding the impacts of the global economic recession, Vietnam's economy continued to attain moderate growth, albeit slower than that immediately after the WTO accession. The economic growth rate reached only 6.2% in 2008, 5.3% in 2009 and 6.8% in 2010 (Figure 2). These figures resemble a fall from that of 8.5% in 2007, whilst being significantly smaller than the expectations prior to the WTO accession (Vo Tri Thanh and Nguyen Anh Duong 2009).

Figure 2: Economic growth in Vietnam, 2007-2010



Source: GSO.

The GDP growth continued to be driven by industry-construction sector. However, this sector experienced a decline in its GDP share[3] from around 41.5% in 2006 to roughly 39.8% in 2008, before recovering to 40.2% in 2009 and 41.1% in 2010. In 2009 and 2010, the growth rates of industry - construction sector were 5.5% and 7.7%, respectively. That is,

[3] All share figures are computed at current prices.

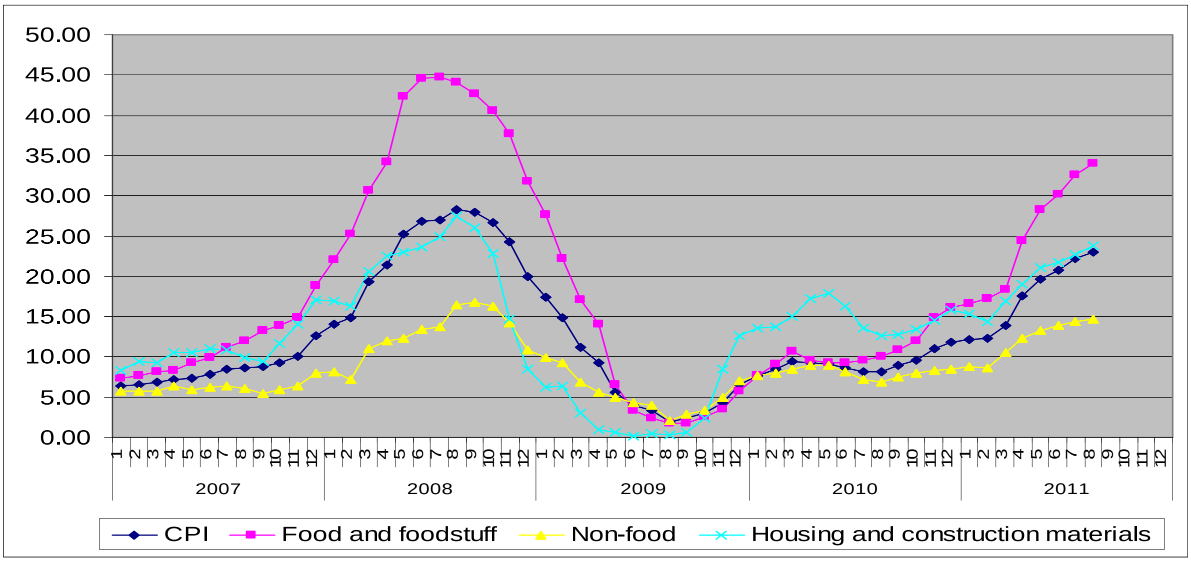
the sector's growth has slowed down dramatically from that before 2008, yet remained faster than overall economic growth. Meanwhile, the share of agriculture-forestry-aquaculture in GDP has risen from 20.3% in 2006 to 22.2% in 2008, before declining to 20.9% in 2009 and 20.6% in 2010. The share of overall services sector in GDP fluctuated in the range between 37.9% and 38.8% during 2007-2010.

Vietnam's economic growth relies heavily on foreign savings. Due to the rapid increase in domestic consumption, domestic savings as a proportion of GDP experienced continuous falls from 30.6% in 2006 to about 28.0% in 2010. The domestic savings-investment gap (much more than 10 percentage points) kept widening, and it could hardly be met by overseas capital in sustainable manner.

Inflation

Since 2007, Vietnam has undergone two periods of relatively high CPI-based inflation, and they constituted new experiences in dealing with macroeconomic instability that has never been encountered before. Year-on-year inflation went up gradually in 2007 before deteriorating rapidly in 2008 (Figure 3). The figure peaked at 28.3% in August 2008 and even attained an enormous rate of 16.5% after removing the prices of food and foodstuff which account for a large share in the CPI basket (about 43%). The administrative upward adjustment of petroleum price in 2008 also induced higher inflation (Vo Tri Thanh and Nguyen Anh Duong 2009).

Figure 3: Year-on-year CPI-based inflation, 2007- Aug 2011 (%)



Source: GSO.

Between September 2008 and September 2009, month-on-month inflation went down significantly, to -0.19% October, -0.76% in November and -0.68% in December, leaving the year-on-year inflation rate of 19.9% for 2008 as a whole. This decline continued until March 2009, when year-on-year inflation reached 11.3% while month-on-month inflation was low. The underlying reasons were of both "good luck" (falling international prices of rice and fuels) and "better policy implementation" (the impact of stabilization policies). In subsequent months until September 2009, year-on-year inflation went down further to 2.4%, yet month-

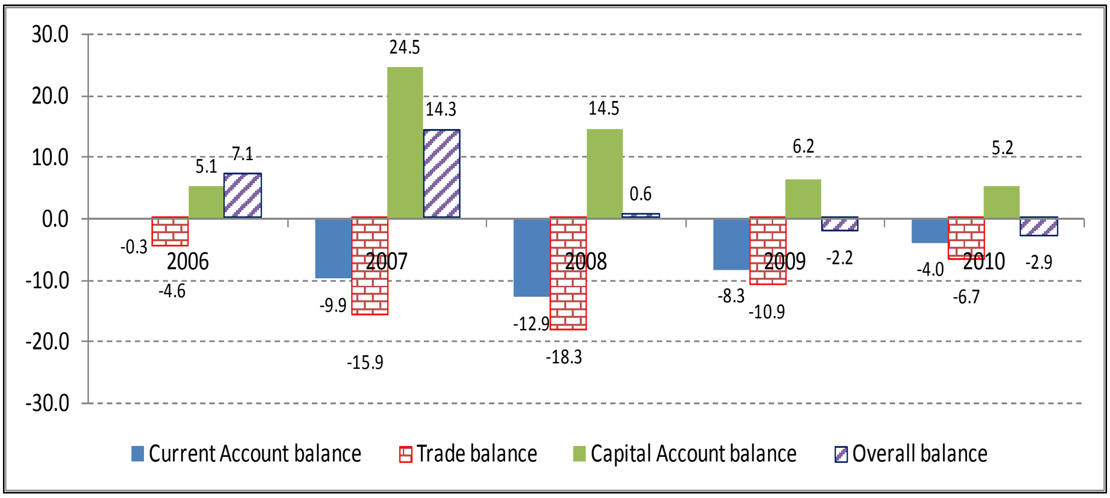
on-month inflation tended to hike[4] due to the increases in money supply, salaries/wages and international prices. During the last quarter of 2009, inflation started to accelerate again: year-on-year inflation rose to over 6.5% in December from just under 3% in October. For 2009 as a whole, the CPI-based inflation rate was reportedly below 6.9%.

Since September 2009, however, inflation started to increase again. However, in early 2010, signs of recovery were yet to be evident while inflation remained far smaller than the peak level of 2008. Therefore, the situation failed to attract actual attention of policymakers, though policies deliberately stated the emphasis on controlling inflation. Year-on-year inflation concluded the year of 2010 at two-digit level, reaching almost 11.8%. Upward trend of the figure appeared to prevail in 2011, exceeding 23.0% in August 2011.

Balance of payment (BOP)

Vietnam continued to run current account deficit (Figure 4). The deficit was valued at USD 7.0 billion (9.9% GDP) in 2007, USD 10.7 billion (12.9% GDP) in 2008, USD 7.7 billion (8.3% GDP) in 2009, and USD 4.3 billion (4.0% GDP) in 2010.[5] However, this result is remarkable, given the fact that the country only had a current account deficit of USD 0.2 billion (or 0.3% of GDP) in 2006. The current account deficit was largely contributed by trade deficit, reaching USD 10.3 billion (15.9% GDP) in 2007, USD 12.8 billion (18.3% GDP) in 2008, USD 10.1 billion (10.9% GDP) in 2009, and USD 7.1 billion (6.7% GDP) in 2010.

Figure 4: Vietnam's balance of payments, 2006-2010 (*Unit: % GDP)*



Source: Compilations from various sources.

In 2007 and 2008, the capital account was in large surplus (USD 18.8 billion and USD 11.2 billion respectively) thanks to the massive capital inflows. Accordingly, the overall BOP surplus was huge in 2007 (USD 10.3 billion), but only USD 0.5 billion in 2008. In 2009, nonetheless, the inflow of foreign investment was smaller, resulting in a smaller capital account surplus (only USD 5.7 billion). This decrease in capital account surplus continued in 2010, as the figure only reached USD 5.5 billion (or 5.2% GDP). As a result, the BOP was in

[4] The month-on-month inflation for the months of April-September 2009 were 0.3%, 0.4%, 0.6%, 0.5%, 0.2%, and 0.6%, respectively.
[5] Source: Vo Tri Thanh and Nguyen Anh Duong (2010), CIEM (2010) and CIEM (2011).

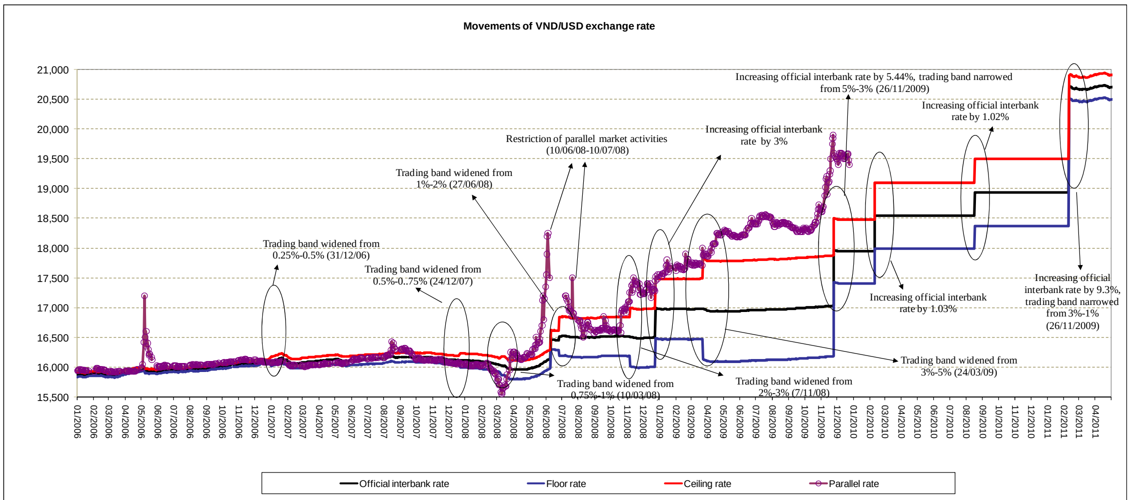
deficit of approximately 2.2% of GDP in 2009, and 2.9% of GDP in 2010. Consequently, this resulted in a significantly declining foreign reserve, which together with inappropriate market structure caused severe pressures at times in the foreign exchange market. As an important note, the errors and omissions item in the BOP remained substantial, amounting to over USD 12 billion in 2009 and about USD 4 billion in 2010, reflecting partly unrecorded smuggling and trade activities and largely the shift of people's asset portfolio towards gold.

2. Inflation in late 2007 – 2008 and policy responses

As previously mentioned, year-on-year inflation remained rather stable, albeit significant, till the 3rd quarter of 2007 (Figure 3). Since September 2007, nonetheless, inflation started to accelerate. By the end of 2007, year-on-year inflation already reached 12.6 percent. In 2008, the figure went up even more drastically and peaked at 28.3% in August.

Vo Tri Thanh and Nguyen Anh Duong (2009) have identified several causes of this rapid surge in inflation. *First*, expansionary macroeconomic policies in previous period, whilst contributing to impressive growth performance, also built up dramatic inflationary pressures. For many years since *Doi Moi* (*Renovation*), particularly since 2000, Vietnam has dedicated her policy efforts to promoting high economic growth and, to a smaller extent, sustaining macroeconomic stability. However, till 2007, the promotion of high economic growth rested heavily on expanding investment and credit. Total investment grew on average by 15.3% p.a. in the years 2000-07, while the 2007 rate of growth in investment alone was 27.0%. Similarly, outstanding credit increased by almost 53.9% in 2007. More importantly, the emphasis on simultaneously sustaining high economic growth and macroeconomic stability seemingly reflected the improper recognition of the trade-off between economic growth and inflation. Also, overshadowed by the acceleration of growth and integration attempts, high inflation did not turn out as a severe problem yet. As such, the persisting inflationary pressures till 2007 was underestimated, and stayed without being addressed. As contended by Vo Tri Thanh and Pham Chi Quang (2008), the macroeconomic policy responses up to February 2008 seemed to be less effective in stabilizing the economy and in reducing policy inconsistencies as well as financial risks.

Figure 5: Movement of VND/USD exchange rate



Source: Author's calculations from SBV data.

Second, international prices have been high, while the crawling-peg exchange rate regime produced the effect of importing inflation. For example, prices of primary commodity went up by 29.4% in 2007, and by 24.6% in the first 8 months of 2008, while the figures for energy prices are 44.0% and 32.1%, respectively. In particular, rice price soared in the first 8 months of 2008, by almost 95.0%.[6] From Vietnam's perspective, import price index increased 18.2% in 2008, while the corresponding figure for imported food and foodstuff reached 21.6%. Meanwhile, seeking to promote export growth, Vietnam allowed for gradual devaluation of the nominal VND/USD exchange rate. In this context, however, the country effectively imported inflation from the world market into the domestic one.

Third, the massive unprecedented increase in foreign capital inflows in 2007 left policymakers with enormous perplexity, particularly in formulating policy response. Vietnam's accession to the WTO in 2007 also made foreign investors become more confident in the country's development prospect. This led to the dramatic surge capital inflows even prior to the accession. As shown in Section 1, registered (implemented) FDI increased dramatically to USD 12 billion (USD 4.1 billion) in 2006 and USD 21.3 billion (USD 8.0 billion) on 2007, compared with the figures of just USD 6.8 billion (USD 3.3 billion) in 2005.[7] Portfolio investment also rose from USD 865 million in 2006 to USD 1,313 million and USD 6,243 million in 2007 and 2008, respectively. More importantly, the foreign capital flows mainly targeted investment in the securities and real estate markets, rather than those directly affecting production capacity.

Facing the sudden surge in capital inflows while keeping the crawling-peg exchange rate regime to promote export growth, Vietnam had to increase its supply of the domestic currency (VND) in exchange for foreign currencies. However, the country did not carry out sterilisation measures to a reasonable extent, leading to the dramatic increase in money supply. The attempt to control money supply in the second half of 2007 was ineffective (and costly), as it was accompanied by the inadequate sterilisation in supplying the domestic currencies for the inflows of foreign exchanges. In 2007 as a whole, M2 went up by almost 49.1% (much higher than that of 29.7% in 2006). Subsequent administrative measures in early 2008 to withdraw money failed to produce the desired effect, while leaving a number of banks, particularly small ones, with liquidity shortage.

The comprehensive policy responses, which marked a turning point in Vietnam's policymaking process, only came with the Political Bureau's Conclusion No. 22-KL/BCT and Government Resolution No. 10/2008/NQ-CP dated 17 April 2008. These set out the objectives and policy packages more clearly and consistently. Specifically, the most essential policy target is to control inflation and to stabilize the (macro)-economy, while the growth target would be lowered. Besides, the Government Resolution specified 8 policy directions (including monetary policy, exchange rate policy, fiscal policy and public investment, trade policy, price policy, capital flows management, social safety net policy, and information and communication policy) for coordinated implementation. A summary of follow-up policies are as follows.

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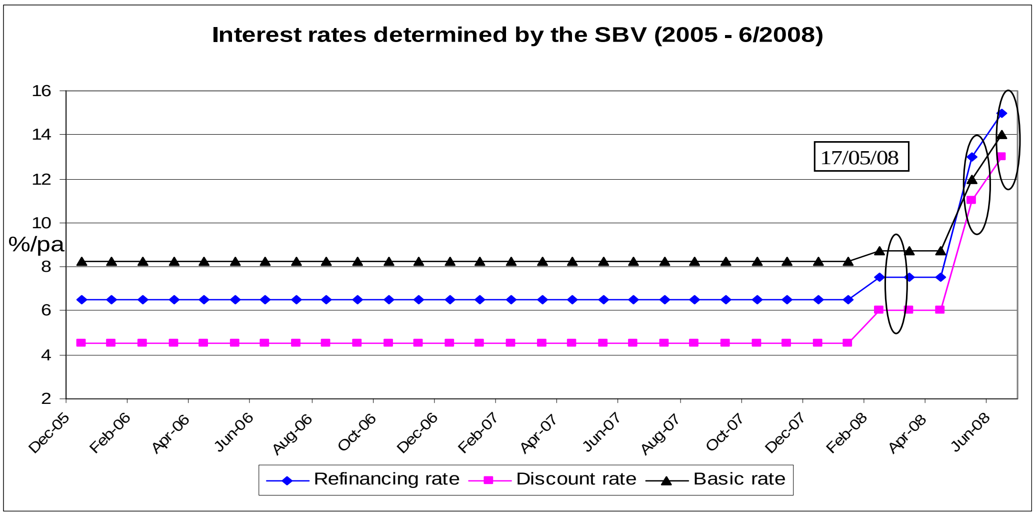
[6] Based on price of Thai rice. Source: International Financial Statistics.
[7] The figures reflected registered capital of FDI projects, while those in brackets were values of implemented capital.

Monetary policy was tightened with the objective of total credit growth of below 30% in 2008. The reserve requirement ratios increased by one percentage point for all terms and currencies. Policy interest rates, after experiencing a low and stable level during 2005-2007, started rising more or less in February 2008 and then increased sharply on 17 May 2008 (Figure 6). As a result, short-run deposit rates and lending rates in June 2008 reached 17-18%/year and 23%-25%/year, respectively. In addition, the requirements on reporting regime of commercial banks and the close supervision over credit institutions, particularly with loans relating to real estate and securities were strengthened.

Figure 6: The interest rates determined by the SBV (2005-6/2008)



Source: Data provided by the SBV

Regarding exchange rate policy, the band for exchange rate fluctuation was cautiously expanded from 0.5% to 0.75% on 24 December 2007, to 1% on 10 March 2008 and 2% (plus an official VND/USD rate increase from 16,139 to 16,461) on 27 June 2008 (Figure 5). Besides, the supervision and checking of foreign currency exchange agents, banning the sales of foreign currencies to individuals were exercised in May 2008, the time of the USD fever. Yet these measures seemed to be enforced in a short period of time. In late June 2008, the SBV banned commercial banks to buy and sell USD through a third foreign currency. The SBV has also intervened constantly in the foreign exchange market. By the end of July 2008, both inter-bank and parallel rates moved to below the ceiling official band. The pressure on VND depreciation, however, remained.

Fiscal policy was also tightened, starting with the request of reducing 10% of the budget current expenditure. The Government also requested ministries and localities, the large SOEs, especially State Business Groups, to reduce the investments outside the so-called “core business” (especially in the financial and real estate sectors) as well as rescheduling/cutting unnecessary or inefficient investment projects. By 25 July 2008, various public/SOE investments of VND 36,000 billion (more than USD 2.1 billion) were reportedly cut or rescheduled. Nevertheless, the actual progress of reducing public/SOE investment was rather slow, and was later ignored as the country switched to demand stimulus to prevent economic downturn.

Trade policy has been adjusted to some extent toward removing difficulties in exports. In addition, trade policy shifted from reducing import tariff in 2007 to increasing import tariff of many products to narrow trade deficit. Quota was imposed on rice export to ensure national food security. This contributed to smaller trade deficit in the first half of 2008. The effect of controlling imports and increasing tariffs cannot be denied, but it is important not to abuse these measures.

Price controls continued to be exercised. Petrol price increased by 12% in February 2008 and remained unchanged (together with prices of cements, steel, coal, drugs, air ticket and train ticket) until June 2008. This price then rose further by 31% in July 2008. In addition, the Government also instructed to stabilize the prices of electricity, drinking water and bus fare till end 2008. These measures prevented some prices from going up, but were accompanied by substantial burden of subsidies and distortion of resources. While market-based intervention remained largely absent, this raised a concern about the sustainability of administrative price control.

To foreign capital flows, Vietnam was quite open. The need for managing such flows, however, prevailed. Yet in doing so, the current issue is to strengthen the transparency of capital flows. In fact, information and statistics of capital inflows/outflows are still rather limited and not very reliable (Vo Tri Thanh 2008; Vo Tri Thanh and Pham Chi Quang 2008). Another issue is how to find out and apply appropriate measures to manage capital flows in the context of high current account deficit and “mixed” confidence of foreign investors.

Various social policies were also implemented to support the poor and other vulnerable groups. Examples are those dealing with hunger and poverty situation, providing supports to households affected by natural disasters and diseases, supporting fisherman to procure and build fishing boats, etc. Yet these measures were already undertaken regularly. Besides, there is a lack of robust analysis of the social impacts resulting from slower economic growth, food price volatility and spiralling energy prices. These undermined the concreteness of the solutions to support the poor and vulnerable groups in the context of macroeconomic turbulence.

The Government also insisted on disseminating information on socio-economic situation and economic policies in transparent and accountable ways, to make clear their message of macroeconomic stabilization well received by the market. Yet in this aspect, the Government has been rather weak (Vo Tri Thanh 2008). The lack of close coordination between ministries, ministerial-line agencies and localities triggered suspicious psychology of the public and market. Information on Vietnam's macroeconomic situation, to a significant extent, has been very much dominated by (private/foreign) financial institutions which may not sufficiently avoid conflict of interest.

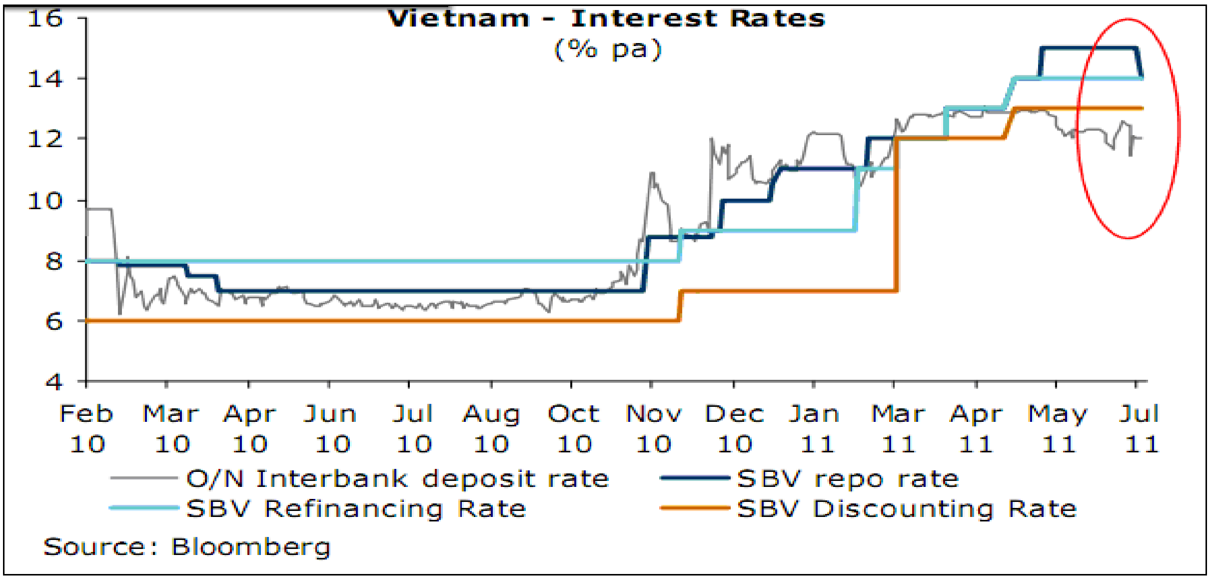
The above policy measures together with negative impacts of the global financial crisis and economic recession led to absolute falls in price in late 2008. Even at this stage, it is almost impossible to track out the extent to which the policy measures actually produced the desired effect. Nonetheless, in times of greater turbulence, this marked a valuable first effort of the Government in adapting themselves to more target-based comprehensive policymaking process.

3. Inflation since late 2010 and policy responses

In the face of re-surmounting inflation in late 2010, the Government of Vietnam decided to undertake bold and comprehensive measures to stabilize the macroeconomic environment. In late February 2011, the Government issued Resolution 11 setting out key policy directions for such measures.

First, attempts would be made to tighten monetary policy. The specific target for M2 growth was lowered to 15-16% in 2011, as compared with actual figure of 25% in 2010. Meanwhile, credit growth for 2011 was constrained at below 20%, as compared with about 30% in 2010. In line with this, the SBV decided to raise the rates of key monetary instruments for several times. Ultimately, the refinancing rate went up to 14% in April 2011 from that of 9% in early 2011. Similarly, the rediscount rate rose from 7% to 13% in the same period. The repo rate at open-market-operations transactions was also lifted, albeit more gradually, from 10% to 15% (Figure 7). Together with these adjustments, the SBV also applied administrative targets to operations of the commercial banks, thereby constraining growth of credit and M2. Consequently, by the end of July (compared to end of 2010), M2 only went up by 3.5%, while credit growth attained 7.8%.

Figure 7: Changes in key policy rates, February 2010-July 2011



Second, the Government would make joint efforts to tighten fiscal policy and to cut down public investment. Specifically, budget deficit would be kept at below 5% of GDP. Meanwhile, public investment is to be cut from all sources, including investment from budget, bond issuance, state credit; and from SOE earnings. In the first 8 months of 2011, budget revenues attained VND 411.4 trillion (69.1% of the planned figure), while budget expenditure was VND 450.7 trillion (or 62.1% of the planned figure), of which implemented investment accounted for VND 111.1 trillion (58.3% of the planned figure). By the end of July 2011, reduction of public investment projects reportedly amounted to VND 81.5 trillion[8].

[8] It is not clear whether the figure includes the transfers of funds from one project to another and the credits the SOEs attempt to get.

Third, joints measures will be dedicated to easing pressures on the foreign-exchange market and making VND more attractive. These include: (i) imposition of ceiling of 14% on VND-denominated deposits and 3% (and subsequently to 2%) on USD-denominated deposits; (ii) raising the required reserve ratio on USD-denominated deposit from 4% to 6%, 7% and then to 8%; (iii) control imports (in complying with WTO commitments) and lending in USD (more restrictive conditions); (iv) introducing surrender policy for SOEs, esp. the large corporations; *and* (v) implementation of some intervention in "parallel market". However, these measures have not always been fully complied with the desired results. As an instance, the ceilings on VND-denominated deposits failed to be binding in practice, due to general liquidity shortage and competition between backs. Specifically, the interest rate on VND-denominated deposit was reported at 15.5% on average, though being recorded at 14.0%. That is, imposing administrative ceiling actually produced the side effect of undermining market transparency.

Finally, the Government implemented several measures to support areas of priorities, such as SMEs and agricultural business activities, and to ensure social security. In April 2011, the Prime Minister approved the rescheduling of corporate-income-tax payment for certain groups of SMEs in the period of one-year. Billions of VND were spent for subsidizing various consumer products, thereby helping to restrain inflation.

To date, the economic performance after the Resolution 11 is still mixed (Table 2). Year-on-year GDP growth reached 5.4 percent for the 1st quarter of 2011, and attained 5.6 percent for the 1st half of the year. Industrial index continued to rise, albeit at a slower pace. Yet inventory appeared to be overly accumulated, reflected by the year-on-year growth of 17.8% in early August. The number of employees also went down by 3.8% in August on an – year-on-year basis. Total investment decreased relative to GDP (at current prices). Together with efforts to cut down public investment, investment from the Budget decelerated, reaching a growth of only 8.6% on an year-on-year basis. Merchandise trade continued to expand, with export growth being faster than import growth.

Table 2: Some Key Economic Indicators, January-June 2011 (*Unit: Percent)*

	1st Quarter 2011	**Jan - Aug 2011**
Real GDP Growth	5.4	5.6 (a)
Industrial Index Growth (*Manufacturing index)*	…	7.3 *(10.7)*
Total Investment/Current GDP	41.2	38.3 (a)
Growth of Investment from Budget	19.6	8.7
Growth of Total Retail Sales *(in real terms)*	22.6 *(8.7)*	22.2 *(3.9)*
Merchandise Export Growth	33.7	33.7
Merchandise Import Growth	23.8	25.4
Trade Deficit (USD billion)	3.1 (22.3 – 19.2)	6.2 (67.0 – 60.8)
CPI-based inflation (yoy) - Change in Gold Price Index (yoy) - Change in USD Price Index (yoy)	13.9 41.3 12.1	23.0 47.6 8.6

Note: a- figure for the 1st half of 2011

Source: Author's compilations from various sources.

The market responses to the Resolution No. 11 and related measures have been generally positive, though participants remained doubtful about whether the efforts brought about desired level of macroeconomic stability. Since April 2011, the nominal exchange rate has been relatively stabilized, with the gap between official and parallel exchange rates being almost negligible. Also, there has been a shift from holding USD into holding VND, but only on a short-term basis. This tendency could be explained by the persistently high depreciation pressure on VND/USD exchange rate due to high inflation and huge trade deficit. Over time, there emerge larger concerns of borrowings in USD by firms in an attempt to exploit the substantial gap between VND and USD interest rates. In connection with this, the market remained skeptical about whether macroeconomic situation has exhibited fundamental improvement. The CDS premium on 5-year Government bond increased again after some short period of declining. Meanwhile, credit ratings of the country stayed unchanged relative to the level before Resolution 11/NQ-CP.

More importantly, the effectiveness of inflation control remains largely questionable. Despite enormous and successive pressures for combating inflation, inflation has shown no sign of going down. In fact, month-on-month inflation was high even after the Resolution 11/NQ-CP, and only contracted in June before going up again. Also, there is virtually no further room for containing cost-push inflation, since tariff is almost zero, interest rates are high while there are neither strategic reserves nor subsidies.

In addition, drawing from similar experiences in inflation control in 2008, market participants started to cast greater doubt about the actual seriousness of Resolution 11 along the course of its implementation. There were several justifications for this. On the one hand, things failed to go smoothly during "the transfer of Government powers". As mentioned previously, month-on-month inflation has been high even in May and July 2011, during the respective elections of the National Assembly members and of new Government - when bold measures were rarely undertaken. On the other hand, the efforts to tighten of fiscal policy and public investment so far may not have sufficed for relaxing inflationary pressures. Putting additional efforts may make the dosage to surpass what is needed for macroeconomic stabilization. Meanwhile, the Government encountered tough and mounting pressures from business communities and other interest groups who suffered from business and social difficulties. Facing this dilemma, the agencies involved in this process appear to divert their attention away from the final target (i.e. inflation) towards intermediate ones (i.e. the extent to which they have achieved those set out in Resolution 11).

At this stage, the world economy is undergoing slower recovery than expected. Meanwhile, world economic development still embodies substances of uncertainty, with the prolonged global imbalances complicated by the worsening of public debt in the EU and the US, by high commodity prices and by non-traditional security issues. Given this difficult context, the economic outlook for the rest of 2011 is deteriorating over time (Table 3). Initially, inflation was even expected to be stabilized and to decline in about 2 quarters after Resolution 11, due to policy lags and inflation inertia. Nonetheless, this only comes in the absence of significant external shocks with serious implementation of the Resolution. From the past months' experiences, therefore, Vietnam should now stick herself to rapid and successful macroeconomic stabilization. Whilst bearing some short-term costs related to

slower growth, this lays the foundation for both higher growth (of about 6.5 -7.0%, maybe) and lower inflation (of less than 8%, maybe) in 2012.

Table 3: Changes in forecasts for 2011

	Inflation (%)	Growth (%)
Planned Targets (Dec 2010)	7.0	7.0
January 2010 - March 2011	7.5-8.5	?7
April 2011	9.0-13.5	6.5-7.0
May-June 2011 *- CIEM (Quarterly-data-based experimental model)*	15.0-17.0 *16.7*	6.0 or less *5.3*
July-August 2011	19.0 – 20.0	5.0 – 5.5

Source: Author's compilations from various sources.

However, of crucial importance now is whether the Government can have enough determination and patience, at least in the market participants' belief. As a key message, macroeconomic stability constitutes an essential foundation for ensuring efficiency of resource allocation and sustaining high economic growth. In connection with this, the country should shift from "easy money – based growth" to "hard money – based growth".

4. Key Lessons in Vietnam's Macroeconomic Stabilization

The past five years have presented Vietnam with interesting economic evolvement, including new ones that had ever been encountered before. Together with international economic integration process, this contributed to broadening the development experiences of the country on her way to industrialization. Combating inflation in such a context, even so, could by no means resemble the attempts made for curbing inflation in mid-1980s. Section 2 and Section 3 clearly elaborate on the complicated aspects of controlling inflation in various sub-periods after Vietnam integrated herself more deeply into the world economy. In light of this, there are several lessons that can be drawn from policy attempts in these sub-periods as follows.

First, in the face of (potentially) plummeting inflation, the Government needs to issue a clear message to the market about their stance towards stabilizing the macroeconomic environment. Having undergone through a long period of growth-induced expansion of credit and investment, such a message is critical to ensure that market participants realize the Government's first priority for reducing inflation. Underlying this message is the acknowledgement of trade-off between economic growth and inflation. The virtual absence of this acknowledgement in mid-2008 prevented thorough measures for macroeconomic stabilization, and inflation fell in late 2008 largely due to impacts of the global economic recession. Issuing a clear message for macroeconomic stabilization is the first essential step, but adhering to such a message boasts even greater importance. That is, any changes in policies, including even policy stance, should be fully justifiable and accountable by concerned agencies. The call for relaxing monetary policy in June-July 2011 by different interest groups, including even some ministries, did more harm than good to the realization of targets set out in Resolution 11.

Second, the policy attempts should be consistent with the goal set out in the policy message. In other words, striving to switch towards macroeconomic stabilization after a long period of growth promotion, Vietnam should harmonize their policy efforts for reducing inflation. Specifically, macroeconomic stabilization should not be deemed as the target of either monetary policy or fiscal policy. For example, the target of inflation reduction could not be achieved by tightened monetary policy while fiscal policy failed to act in the sufficiently cooperative manner. Maintaining policy consistency is in this sense critical, notwithstanding the difficulty induced by different macroeconomic policies being approved at different paces. Without policy consistency, market participants may quickly interpret the level of seriousness towards macroeconomic stabilization. Accordingly, they may build expectations unfavourable to realizing the policy target. More fundamentally, therefore, curbing inflation in Vietnam should go in line with longer-term measures to address inherent macroeconomic imbalances.

Third, the macroeconomic policies should be properly cooperated and coordinated. There is no fixed doctrine for this. As an "art", the formulation of these policies should serve a common final target, depending on the context and the extent to which the trade off between inflation and growth is acceptable. Proper coordination and cooperation of macroeconomic policies also help to ensure policy consistency, thereby consolidating market confidence in the target of inflation control. Most importantly, policy coordination and cooperation necessitate attempts to improve accountability of relevant Government agencies. Such an improvement in turn plays a pivotal role in enhancing policy credibility in the longer run.

Fourth, Vietnam should carefully consider her choice of exchange rate regime. At this stage, the country pursues a crawling-peg exchange rate system, with gradual adjustment to support export growth and restrain trade deficit. Nevertheless, past devaluations of VND/USD exchange rate were well shadowed by relatively high domestic inflation[9] and, thus, had almost no inducement of export growth as desired. Meanwhile, they facilitate the so-called "import of inflation" to Vietnam, particularly when international market prices are high (eg. in 2008). In the short-term, the country should maintain the current exchange rate system. Of key essence is the assurance of competitiveness and flexibility of the exchange rate, thereby contributing to effective monetary policy, particularly in the context of high capital mobility and dollarization. As a bottom line, ensuring the macroeconomic policy consistency is essential for avoiding financial speculation and crisis.[10]

Fifth, together with macroeconomic policies, adequate attention should be paid to improving financial monitoring and surveillance system. This system helps issues early warning signals of financial stress, including macroeconomic-related financial risks. During times of tightened macroeconomic policies, the need for this system rises even more. As an instance, in the context of relatively scarce credit, surveillance helps to identify risks and prevent collapse in other important markets (such as real estate and stock markets). The capacity for warning financial stress and risks remains inadequate. Underlying this is the

[9] See Truong Dinh Tuyen et al (2011).

[10] Macroeconomic policy consistency reflects the maintaining the sustainable relationship between exchange rates and interest rates at any point in time: CPI: $i = i^* + fd$ (forward) or UPI: $i = i^* + \Delta se$ (expected depreciation)

recognition of so-called “impossible trinity” in the context of high capital mobility. The policy responses should embody larger favour of exchange rate flexibility, financial supervision strengthening and policy coordination.

Sixth, in times of high inflation with tightened macroeconomic policies, Vietnam should dedicate proper support to disadvantaged groups (i.e. the poor). During the past decades, the country has made profound achievement in reducing poverty incidence. With continuing economic growth, there is the possibility for further poverty reduction. However, while such a growth often fails to be beneficial for *everyone*, high inflation may erode the living standards of the poor and near-poor, thereby reverting the progress in poverty reduction. Given that the country has to implement commitments for liberalizing prices of key products, subsidizing such products may not be available; nor will subsidy be efficient since it also benefit the rich. The attempts to directly support the poor and other disadvantaged groups were reasonable. Yet whether they could be repeated in the future depends to a significant extent upon the room of the State Budget and firms to accommodate larger provisions to the poor and employees, respectively.

Finally, in controlling inflation, Vietnam should retreat from using administrative measures. Furthermore, Vietnam should go on to retreat from policy-making stereotype based on administrative measures. Such measures may produce desired impacts in a relatively short period of time. For example, constraining credit growth after the Resolution 11 led to significantly slower expansion of credit, thereby easing inflationary pressures from the monetary side. However, these types of measures fail to be sustainable since they are not based on robust market relations. As discussed in Section 3, the ceiling on VND-denominated deposit rate failed to be binding as it could not supply credit institutions with sufficient liquidity, particularly in the context of tightened monetary policy. Therefore, refraining from using administrative intervention may actually help improve the credibility and predictability of policies, which facilitate effective interactions between the State agencies and market participants in the long run./.

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