AMRO Country Report
ACR/24-05

AMRO Annual Consultation Report

Vietnam - 2023

ASEAN+3 Macroeconomic Research Office (AMRO)

April 2024

Acknowledgments

1. This Annual Consultation Report on Vietnam has been prepared in accordance with the functions of AMRO to monitor, assess and report on 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 Visit of AMRO to Vietnam from September 20 – October 3, 2023 (Article 5 (b) of the AMRO Agreement). The AMRO Mission team was headed by Sumio Ishikawa Group Head and Lead Economist. Members included Wanwisa Vorranikulkij, Country Economist for Vietnam; Jade Vichyanond, Back-up Economist; Thanh Trung Vu, Back-up Economist; Siang Leng Wong, Financial Sector Specialist; Sungtaek Kwon, Senior Economist; Thanh Thuy Giang Dao, Associate; and Thu Trang Vu, Associate. AMRO Director Kouqing Li and Chief Economist Hoe Ee Khor also participated in key policy meetings with the authorities. This AMRO Annual Consultation Report on Vietnam for 2023 was peer reviewed by economist group from AMRO's country surveillance, financial surveillance, fiscal surveillance, and policy review teams; endorsed by Jiangyan Yu, Senior Economist, Policy and Review Group; and approved by Dr Hoe Ee Khor, AMRO Chief Economist.
3. The analysis in this Report is based on information available up to December 31, 2023.
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

1. Vietnam's economic growth weakened in H1 2023, primarily due to external headwinds and a downturn in the housing market, then improved in the Q3. Subdued overseas orders led to weak manufacturing production, delayed capital investment and job retrenchment in H1, before picking up in Q3. Construction and real estate market activity, especially residential buildings, remains lukewarm. The Vietnamese economy grew at 5.1 percent in 2023 and is forecast to expand at 6.0 percent in 2024 on the back of improving exports.

2. Inflationary pressure remains under control. Headline inflation has been well below the government's 4.5 percent annual target[1], due to softening domestic demand, adequate domestic food production, and administered prices. After averaging at 3.3 percent in 2023, inflation is forecast to rise to 3.6 percent in 2024.

3. Despite the weak external demand, the balance of payments is expected to register a surplus in 2023. Export contraction will likely be offset by import compression and a recovery in tourism. FDI inflows have continued to be strong amid global supply chain reconfiguration. Trade surpluses and resilient FDI inflows are the key factors behind the overall balance of payments surplus.

4. Vietnamese authorities have employed macroeconomic policy judiciously to tackle the weakening economic growth. Value-added tax (VAT) has been cut temporarily to reduce prices affecting households' living expenses, while deferrals of VAT, corporate income tax, personal income tax on self-employed businesses, and land rent were introduced in H2 2023 to alleviate the financial burdens of enterprises. The central bank cut operating interest rates four times in 2023 and rolled out credit support measures to ease the pressure on borrowers.

5. Risks to the growth outlook are tilted toward the downside. The main downside risk would stem from external factors, including a recession in the European Union and the United States as well as a faltering of economic recovery in China. Domestically, some real estate developers are facing lingering risks of subdued revenue and financial distress. There are upside risks to consumer prices stemming from rising global oil prices, extreme weather affecting food production, and depreciation of the Vietnamese dong.

6. Asset quality in the financial sector has deteriorated. The weakening economic activities have led to rising non-performing loans. Restructured loans also mask the underlying weak credit quality. Some property developers are struggling to repay debt, refinance bank loans and roll over bonds, and thus face heightening difficulties to meet payment obligations.

7. Vietnam's long-term growth potential faces a confluence of structural challenges. The country's high growth is primarily attributable to multinational corporations (MNCs); however, domestic supply chains need to be built up as part of the manufacturing ecosystem. Local micro, small and medium-sized enterprises (MSMEs) have faced difficulties in advancing up the value chains. Skilled labor is also in shortage. Additionally, the country faces intensifying climate risks and exposure to extreme weather due to the concentration of economic activities along the extensive coastline. Lastly, Vietnam is one of the most rapidly aging countries in the region, which may lead to a decline in the labor force in the next ten years[2].

8. In light of uncertainty over the growth prospects, an appropriate policy mix should be employed to support growth while maintaining financial stability.

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[1] The inflation target of the State Bank of Vietnam (SBV) differs from that of countries adopting the inflation targeting monetary framework. Vietnam's annual inflation target serves as an operational ceiling. Based on anecdotal evidence, when headline inflation in Vietnam approaches its annual target, the government would implement measures to curb inflation.

[2] This is based on the projection of the Vietnamese population aged between 15 and 59 years old by the Population Division of the United Nations.

- Fiscal policy should play a leading role in bolstering the economy, with support measures recalibrated to enhance effectiveness and target vulnerable groups. Tax reductions, besides VAT and old-related taxes, and tax credits could be considered, while VAT refunds and disbursement of public investment should also be expedited.
- Maintaining the accommodative monetary policy stance would ease the financial burden on MSMEs and heavily indebted households. In this context, the approval process of credit support schemes should be streamlined further.
- Capital and liquidity buffers of banks should be strengthened in light of rising credit and liquidity risks. While the banking system progresses toward full implementation of Basel II standards, it is also worth considering the introduction of higher quality capital and additional capital requirements on domestic systemically important banks.
- Macroprudential regulations, such as lowering loan concentration limits or loan-to-value ratios, should be put in place to contain potential systemic risks arising from the housing market and curb speculative demand. Stamp duties or property taxes can also be levied on the purchase of second and subsequent homes.

9. Concerted efforts should be made to address structural challenges that hinder long-term growth and promote inclusive and sustainable development. Structural and regulatory reforms should be pursued, including by enhancing fiscal sustainability, modernizing monetary policy, improving financial regulations, and reducing legal bottlenecks in the real estate sector.

- To overcome government challenges in implementing targeted measures, the social protection system could be strengthened, which would establish a comprehensive and centralized database of MSMEs and underprivileged households. Increasing MSMEs' financing access by enhancing credit guarantee schemes could also be considered.
- The AMRO mission commends the State Bank of Vietnam's (SBV) ongoing efforts to modernize monetary policy and further liberalize the foreign exchange rate regime. Ensuring price stability should be SBV's primary objective, to mitigate policy conflicts that might arise from multiple objectives. The credit growth target should be phased out over time to pave the way for a more market-based policy.
- Regulatory and structural reforms are necessary in the financial system. Mergers and acquisitions between the stronger and weaker banks could be encouraged to leverage economies of scale. Corporate governance should be enhanced to minimize cross-ownership in the banking sector. Moreover, the banking resolution framework can be improved to ensure orderly and timely resolution of distressed banks. In the corporate bond market, rules on investor protection and information disclosure should be enhanced, while greater efforts should be directed at financial literacy programs.
- The turbulence arising from the housing market also necessitates addressing legal bottlenecks and data gaps related to real estate and construction.
- In view of the shortage of skilled labor, greater efforts and financial support should be directed toward increasing the availability and quality of vocational training and educational programs.
- To enhance the country's climate resilience, climate change policy measures are necessary to minimize transition risks associated with moving toward a low-carbon economy.

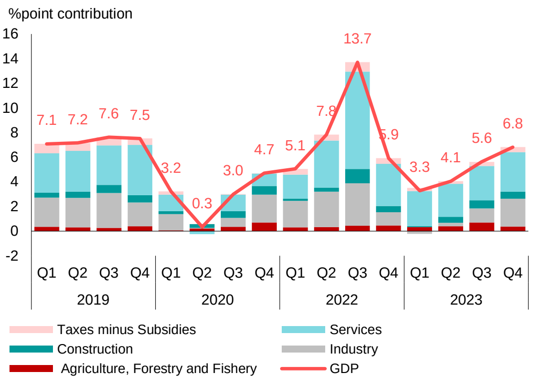
A. Recent Developments and Outlook

Real Sector Developments and Outlook

1. **Vietnam's economic growth weakened to 5.1 percent in 2023, falling short of the government's target of 6.5 percent, primarily due to external headwinds and a downturn in the housing market, then improved in the third quarter.** In H1 2023, the Vietnamese economy grew by 3.7 percent year on year (yoy) (Figure 1). Manufacturing, especially of electronics and textiles, experienced lower exports and subdued new overseas orders. Weak production resulted in delayed non-state capital investment, job losses and reduced operating hours, particularly in export-oriented industries. The construction sector also slowed down, reflecting sluggish activity in the housing market. The number of new business registrations declined, and the number of business dissolutions increased, especially in real estate-related services sector. Uncertainty in the employment outlook dampened consumer confidence and thus household consumption. However, in H2 2023, the economy showed signs of bottoming out, with improving business sentiment, a recovery in new orders and a gradual increase in employment.

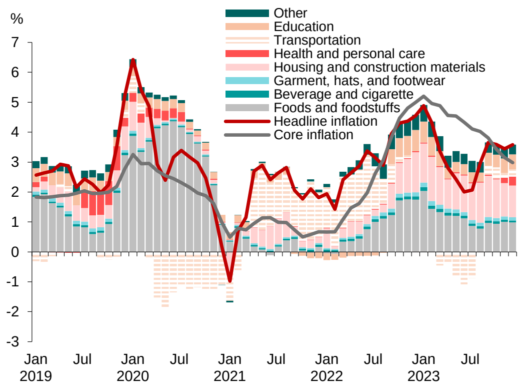
2. **Growth is projected to rise to 6.0 percent in 2024.** On the external front, the retail goods sales in the United States (U.S.) and the global semiconductor market are expected to improve in 2024, while the European Union (EU) economy is forecast to strengthen. As a result, Vietnam's exports, especially in electronics, is forecast to recover moderately next year. The outlook for the construction and real estate sectors remains uncertain despite easing financing conditions. An increase in tourist arrivals would bolster private consumption and growth. Additionally, accommodative monetary policy, together with supportive fiscal measures, will shore up growth and help offset impacts from external headwinds.

Figure 1. Real GDP Growth



Source: GSO; CEIC; AMRO staff calculations

Figure 2. Consumer Price Inflation



Source: GSO; CEIC; AMRO staff calculations

3. **Inflationary pressure remains under control.** Consumer price inflation declined sharply to 2.0 percent in June 2023 from 4.9 percent in January 2023, thanks to softening domestic demand, declining oil prices, adequate domestic food production, and administered prices. The softening headline inflation was also due to the use of an oil price stabilization fund, environmental tax cut on fuel, and import tax cut on oil and gasoline to cap increases in fuel prices. Headline inflation has accelerated since July 2023 due to increases in housing rent and in domestic food and global oil prices. Despite a temporary 2 percent cut in value-added tax (VAT), the annual average of headline inflation was 3.3 percent for the whole year,

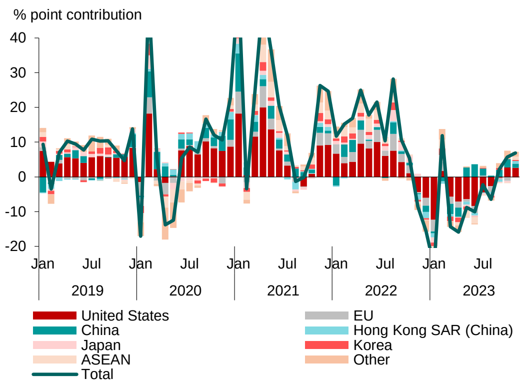
up slightly from 3.2 percent in 2022. Meanwhile, the annual average of core inflation remained elevated at 4.2 percent in 2023, reflecting higher cost of services and increasing rents (Figure 2).

External Sector and the Balance of Payments

4. **After a robust recovery in 2022, Vietnam's exports have contracted sharply so far 2023 on the back of weak external demand.** Exports declined by 4.4 percent (yoy) while imports slumped at 9.1 percent in 2023. The slump was broad-based, with electronics, Vietnam's largest export earner, contracting by 2.7 percent (yoy) during the same period as the slowing global growth momentum was compounded by an electronics down cycle. While exports to China have picked up following China's reopening, the increase has been insufficient to offset the decline in exports to other key trading partners (Figure 3). On the services side, the number of overseas tourists has risen strongly from last year but still accounted for only around 69.8 percent of pre-pandemic levels. Chinese tourists made up the largest source of foreign arrivals before the pandemic, and their return has been slow compared with other countries due to the later reopening of their borders.

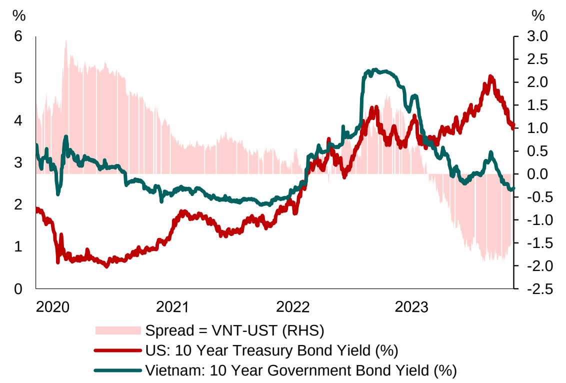
5. **As for financial flows, foreign direct investment (FDI) inflows continued to be relatively strong amid global supply chain reconfiguration, while the banking sector experienced outflows.** Vietnam remains an attractive production hub amid uncertainties surrounding geopolitical tensions, and in light of supply chain disruptions resulting from China's zero-Covid policy lockdowns in 2022. After the reopening of the country in mid-2022, the backlogs of FDI applications during the pandemic eased. Registered FDI in 2023 rose to USD20 billion in 2023 from USD12.4 billion in 2022 while pledged FDI increased by 3.5 percent (yoy) with rising numbers of projects from a broad range of countries. In terms of sector, much of the FDI remains concentrated in manufacturing, followed by construction and real estate. After the authorities issued revised regulation on residents' overseas transfer in late 2022[3], outflows from the banking sector and under-recorded flows – net errors and omissions – increased in H1 2023. Looking ahead, due to divergence in the monetary policy stance of Vietnam and the U.S. (Figure 4), depreciation pressure on the dong will likely persist and may trigger further financial outflows.

Figure 3. Exports by Destination



Source: GSO; CEIC; AMRO staff calculations

Figure 4. Interest Rate Spread between U.S. and Vietnam



Source: GSO; MPI; CEIC; AMRO staff calculations

6. **Trade surpluses and resilient FDI inflows were the key factors behind the balance of payments surplus in 2023.** As Vietnam's exports rely heavily on imported

[3] The SBV issued Circular 20/2022, dated December 20, 2022, to provide more stringent guidance on the transfer of funds from residents in Vietnam to foreign countries. The circular outlines the allowable purposes and transfer limits.

intermediate inputs, the export contraction has been accompanied by a sharp decline in imports, keeping the trade account in surplus. Meanwhile, resilient FDI inflows continued to bolster the financial account. The improvement in the external balance allowed the State Bank of Vietnam (SBV) to add around USD2.6 billion to its foreign reserves during the first ten months of the year – foreign reserves stood at USD89.7 billion as of end-October, equivalent to 2.7 times of short-term external debt.

Monetary Conditions and Financial Sector

6. **In view of muted inflationary pressure, the central bank has cut interest rates to stimulate the economy.** The objectives of SBV's monetary policy are not only ensuring price stability but also contributing to macroeconomic stability and supporting economic growth. As inflation has been contained and the dong exchange rate remains stable, the SBV has room to ease monetary policy to bolster the economy. The annual credit growth target in 2023 was set at 14 - 15 percent in 2023 . In addition, since March 2023, the SBV has cut operating interest rates – refinancing and discount rates – by 150 basis points and lowered open market operation (OMO) interest rates, and temporarily stopped issuance of the State Bank bills, from mid-March to late September, to ensure ample liquidity in the financial system.[4] Caps on short-term deposit rates and short-term lending rates to priority sectors were cut by 50-150 basis points (Table 1). Liquidity in the financial sector is ample, with the overnight interbank rate falling below 1.0 percent (Figure 5) (Selected Issue 1 – Vietnam's Monetary Policy Framework).

Table 1. Change in Operating Interest Rates

Instruments	Prior to March 15	From March 15	From April 3	From May 25	From June 19
<1 month deposit rate cap	1.00%	1.00%	0.50% (-50 bps)	0.50%	0.50%
1-6 month deposit rate cap at commercial banks	6.00%	6.00%	5.50% (-50 bps)	5.00%	4.75% (-25 bps)
1-6 month deposit rate cap at microfinance institutions	6.50%	6.50%	6.0% (-50 bps)	5.50% (-50 bps)	5.25% (-25 bps)
Lending rate cap for loans made to priority sectors by commercial banks	5.50%	5.00% (-50bps)	4.50% (-50 bps)	4.50%	4.00% (-50bps)
Lending rate cap for loans made to priority sectors by microfinance institutions	6.50%	6.00% (-50bps)	5.50%	5.50%	5.00% (-50 bps)
Refinancing rate	6.00%	6.00%	5.50% (-50 bps)	5.00% (-50bps)	4.50% (-50 bps)
Discount rate	4.50%	3.50% (-100bps)	3.50%	3.50%	3.00% (-50 bps)
Overnight lending rate in SBV clearing system	7.00%	6.00% (-100bps)	6.00%	5.50%	5.00% (-50 bps)

Source: SBV; Maybank; AMRO staff compilation

7. **The SBV has rolled out additional financial measures to support the economy, but the usage rate of some of these programs remains low due to complicated terms and conditions.** A 2-percent interest rate support program, in effect since May 2022 as part of the Economic Stimulus Package (Resolution 43/2022/QH15), has a usage rate of only 3.0 percent of the allocated amount of VND40,000 billion as of December 2023. The low utilization is partly due to low demand as most borrowers are not qualified while many are concerned about *ex-post* inspection by the authorities. Both banks and borrowers also find it difficult to justify criteria regarding "borrower's recovery capability" as required by the package, especially amid current economic uncertainties. In 2023, the SBV in collaboration with the

[4] In mid-September, due to a sharp depreciation of the dong against the U.S. dollar, the SBV issued State Bank bills to withdraw liquidity from the system to mitigate the slowdown in currency depreciation.

Ministry of Construction rolled out a VND120 trillion social housing credit package with a preferential interest rate. The utilization rate has been well below two percents thus far as the number of social housing units available for sales was low due to long construction periods. Moreover, banks face challenges in appraising the value of some housing projects when considering loan application. Amid fragile business prospects, a special loan restructuring program (Circular 02/2023/TT-NHNN dated April 23, 2023[5]) is being implemented to allow borrowers to defer principal and interest payments for up to one year, with the payable interest continuing to accrue during the deferral period. (Box A. Loan Restructuring Programs in Vietnam's Banking Sector)

Box A. Loan Restructuring Programs in Vietnam's Banking Sector[6]

The SBV introduced its first loan restructuring program in March 2020 when the Covid-19 pandemic first broke out and strict containment measures were taken to shut down the economy and protect lives. In order to support people and enterprises in overcoming the difficulties, promote production and business activities, and ensure social welfare, the central bank introduced Circular 01/2020/TT-NHNN dated March 13, 2020, which outlined loan restructuring measures to help borrowers affected by the pandemic. The circular offered three options: first, rescheduling repayments; second, maintaining the loan category; and third, waiving or reducing interest and fees related to the loans. The loan restructuring program under Circular 01 ended on June 30, 2022[7].

In April 2023, the SBV launched a second loan restructuring program in response to the lingering effects of the pandemic and the challenging global economic conditions. The export slowdown and real estate downturn have had a detrimental impact on both production and business activities, as well as the well-being of the people. Circular 02/2023/TT-NHNN focuses on two loan restructuring options: rescheduling repayments and maintaining the loan category while reduction of interest rates and fees are not included. The loan restructuring policy is relevant to borrowers experiencing challenges in both production and business activities or in repaying loans that have been taken out for personal consumption. This policy will expire on June 30, 2024.

In summary, SBV's guidelines on loan restructuring are as follows:

Rescheduling repayments	Credit institutions are allowed to adjust payment installments or extend the loan's duration. The two scenarios are as below: • Adjusting payment installments involves postponing the due date of each periodic installment[8], while keeping the entire loan's maturity date unchanged. This may include reducing installments during the rescheduled period and compensating for it by increasing the installments subsequently. • Extending a loan's duration refers to a prolongation of the maturity date[9] when the borrower is unable to pay up fully on the originally agreed maturity date. Additionally, the rescheduling option must ensure the following conditions:

[5] Circular 02/2023/TT-NHNN, dated April 23, 2023, allows banks to restructure certain loans without reclassifying loan categories.
[6] Prepared by Thanh Thuy Giang DAO, Associate
[7] In 2021, the SBV issued Circular 03/2021/TT-NHNN and Circular 14/2021/TT-NHNN to adjust and supplement certain aspects of Circular 01 to ensure it aligns more effectively with practical circumstances.
[8] Periodic installment specifies a regular and recurring payment made by the borrower to repay a loan. It is typically paid at consistent intervals, such as monthly or quarterly basis, over the loan's predetermined term until the entire loan amount is fully repaid, including both the principal (the original borrowed amount) and the interest.
[9] A loan's maturity date specifies the date on which the borrower's final loan payment is due. The borrower is expected to have repaid the entire principal amount, as well as any interest or other charges, by this specific date.

	• Rescheduling under Circular 01 can be applied to loans granted before August 1, 2021, while Circular 02 applies to loans granted before April 24, 2023. • The loan that is being rescheduled must be either current or overdue payments must be less than 10 days past either the due date of a periodic installment or the loan's maturity date. • The period of rescheduling shall align with the borrower's repayment capacity and should not exceed 12 months from the maturity date of the restructured loan outstanding. • The borrowers are assessed to have the ability to fully repay the principal and/or interest within the revised repayment schedule.
Maintaining loan category	Credit institutions are to maintain the category of the restructured loans under the same latest classification each loan was held in accordance with the regular regulations before rescheduling. If the borrower fails to repay the loan as per the rescheduling timeframe, and the credit institution decides not to provide further restructuring, the loan will be reclassified into a higher-risk loan category according to the regular regulations.
Waiving or reducing interest and fees	This loan restructuring option was stipulated only in Circular 01. It allowed the credit institution to make the decision to waive or reduce interest and fees on the outstanding balances of loans that originated before August 1, 2021, and where the obligation to repay the principal and/or interest fell due between January 23, 2020, and June 30, 2022.

A common feature shared by these circulars is that the SBV delegates to credit institutions the autonomy to assess borrowers' financial difficulties and make their own decisions on loan restructuring. The credit institutions bear the responsibility of determining repayment rescheduling and maintaining the loan category according to the regulations specified in these circulars. They are also mandated to carry out internal checks and controls to prevent and deter any abuse of the restructuring policy for illicit gains. Moreover, they are required to establish internal regulations on loan restructuring to ensure consistent implementation across their system.

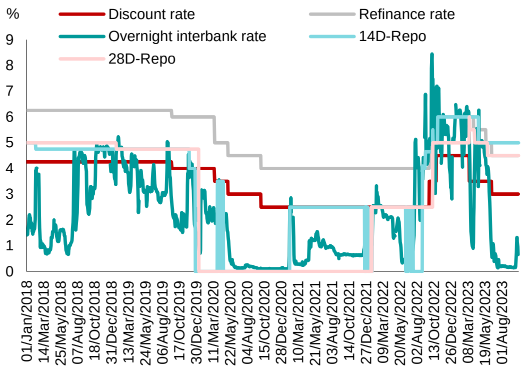
8. **Notwithstanding the easy monetary policy and supportive financial measures, bank lending grew at a slower pace compared with the previous year (Figure 6).** Bank lending grew moderately at 6.9 percent (YTD) in the first nine months of 2023, before accelerating to 13.5 percent (YTD) at the end of the year. Outstanding bond issuances declined, attributable to the weak economic growth and the pessimistic real estate outlook. Notably, bank lending has been predominantly driven by loans to the trade and industrial sectors, which are dependent on external sector developments. Amid economic uncertainty, bank lending to corporates in the trade and industrial sectors grew at 11.9 percent and 7.5 percent (YTD), respectively, by the end of October 2023. State-owned commercial banks (SOCBs) and joint stock banks (JCBs) are reluctant to lend to MSMEs due to rising credit risks.

9. **Banking asset quality has deteriorated, but a recent increase in capital adequacy ratios (CAR) should offer more resilience to potential stresses**. The challenging economic environment has led to a rise in the non-performing loan (NPL) ratio, which climbed from 1.5 percent in 2021 to 2.0 percent in 2022 and further to 4.9 percent in September 2023. Besides, loan restructuring would mask NPLs.[10] On the positive side, banks' CARs have improved over the past few years, bolstering their ability to weather adverse conditions. Loans are covered by deposits at the system-wide level, with loan-to-deposit (LTD) ratios below 100 percent.[11] However, the more systemically important state-owned banks (SOBs) exhibit lower CARs and

[10] Under the debt restructuring provisions of Circular 02/2023/TT-NHNN, the loan category of borrowers remains the same. While credit quality has deteriorated as borrowers face difficulty in servicing their debts, such soured loans are not classified as NPLs on the banking books. The circular took effect in April 2023. Since then, the size of loans restructured under this circular has been about 1.0 percent of outstanding loans. In addition to this circular, around 0.5-0.6 percent of outstanding loans continue to be restructured under Circular 01/2020/TT-NHNN, dated March 13, 2020, which allows credit institutions to restructure loans for borrowers adversely affected by the Covid-19 pandemic.
[11] Underlying data includes loans to financial institutions and deposits from financial institutions and the Treasury.

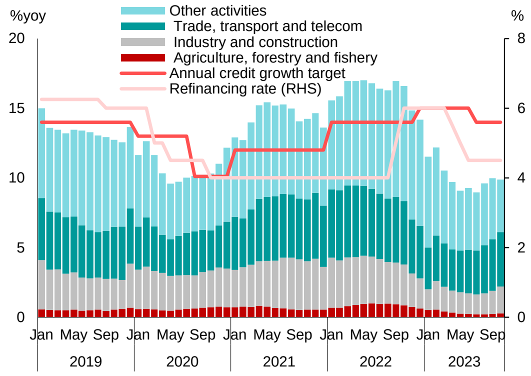
higher LTD ratios, which may affect their capacity to support loan growth. Therefore, as the banking sector remains profitable, retaining profits to build more capital buffers would be prudent. Bank profitability, in terms of return on assets (ROA) and return on equity (ROE), has increased in the past few years despite the pandemic.

Figure 5. OMO and Interbank Rates



Source: SBV; Haver Analytics; Bloomberg

Figure 6. Bank Loan Growth



Source: SBV; CEIC; AMRO staff calculations
Note: Loan growth in this chart is in yoy terms, not YTD.

10. **Activity in the real estate sector remains sluggish after experiencing a downturn since the second half of last year.**[12] Following the boom in early 2022, deteriorating economic and market conditions, alongside the misconduct of some property developers, have largely made homebuyers and investors lose confidence and adopt a wait-and-see attitude, leading to a demand slowdown. Meanwhile, property developers and other businesses have faced major difficulties, including tighter financial conditions, a lack of liquidity in the corporate bond market, subdued demand, declining property prices, and project suspensions or delays. The number of transactions in the real estate market has fallen sharply, with the number of nationwide real estate searches falling by 33 percent (yoy) and the number of properties listed for sales dropping by 44 percent (yoy) in Q2 2023. The absorption rate[13] fell to around 10 percent in Q1 2023 compared with the peak of 69 percent in 2019. Against this background, apartment sales in some segments have started to inch up following the SBV's rate cuts.

Fiscal Sector

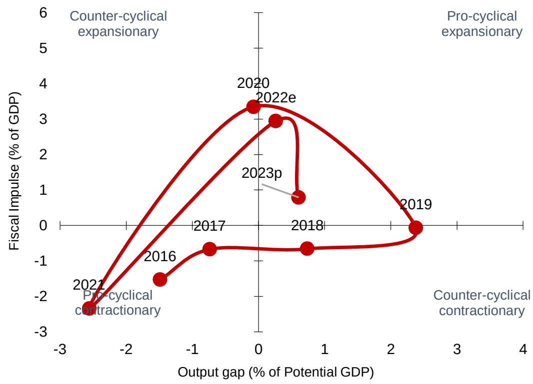
11. **The authorities have employed fiscal policy judiciously to shore up growth.** The Economic Stimulus Package, announced in January 2022, will continue until the end of 2023. To reduce prices of household goods, the government lowered VAT by 2 percentage points in 2023[14], and cut environmental and import taxes on oil and gasoline. Additionally, tax deferrals of VAT, corporate income tax and land rent are effective from July until December 2023 to alleviate the financial burden of enterprises temporarily amid weak demand. Registration fees for domestically manufactured cars have been halved between July 1 and December 31, aimed at helping local automobile enterprises that are facing sluggish demand and high inventories. The government also plans to disburse public capital investment faster,

[12] Vietnam's real estate sector has experienced rapid development in the past decade as the middle class moved to cities alongside swift economic development. Although many homebuyers changed from a bullish stance to a bearish approach during the pandemic, developers continued to supply real estate by obtaining financing from the corporate bond market in addition to bank loans.
[13] The absorption rate refers to the percentage of available properties that were successfully sold during a specified period.
[14] The VAT rate cut is extended until the end of June 2024.

leading to a disbursement rate of capital expenditure of 95 percent in 2023, slightly up from 91.4 percent in 2022.

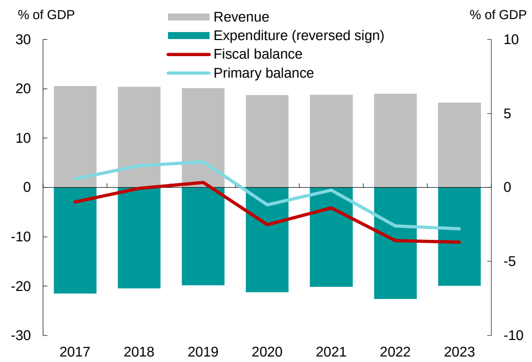
12. **The government employed a neutral fiscal stance in 2023 (Figure 7). Due to** Temporary tax cuts coupled with weak economic conditions, revenue is expected to stay at 17.0 percent of GDP in 2023 (Figure 8). The expenditure also declined to around 20.6 percent of GDP in 2023. The government plans to boost capital investment to stimulate the economy while cutting down on current expenditures. Primarily due to lower tax revenue collection, the budget deficit widened marginally to 3.7 percent of GDP in 2023 from 3.6 percent in 2022. Reflecting the budget deficit, public debt increased from 37.0 percent of GDP at end-2022 to around 34.7 percent at end-2023.

Figure 7. Fiscal Stance



Source: MOF; AMRO staff projections
Note: "e" = estimation

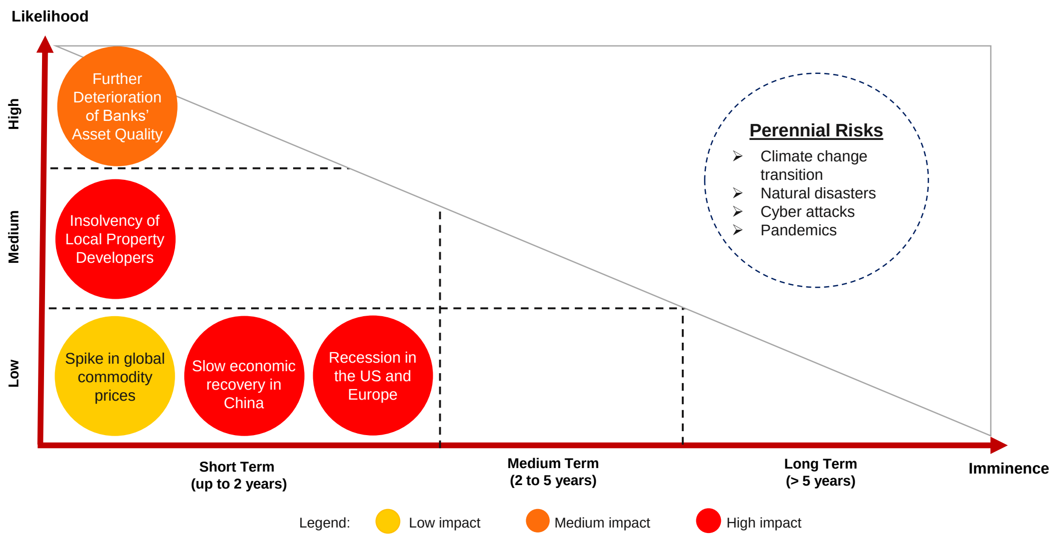
Figure 8. Drivers of Fiscal Balance



Source: MOF; AMRO staff calculations and projections
Note: "e" = estimation

B. Risks, Vulnerabilities and Challenges

Country Risk Map: Vietnam



Source: AMRO staff

B.1 Near-term Risks to the Macro Outlook

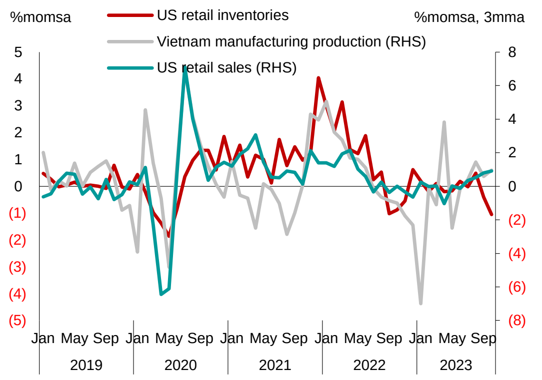
13. **Risks to the growth outlook are tilted toward the downside.** The main downside risk would stem from external factors – including a recession in the E.U. or U.S., and a faltering economic recovery in China. The recovery of Vietnam's exports and thus manufacturing production will be delayed from the AMRO baseline projection if the economic performance of these main trade partners is worse than expected, and if the recovery in the U.S. retail sales (Figure 9) and the demand for global smartphone and semiconductor products are slower than expected. Additionally, a rise in global inflation, led by a renewed spike in global commodity prices, could further dampen external demand. In addition, the sluggish real estate market, with an oversupply of high-end condominiums, could be worsened by delays in implementing effective resolutions, including lengthy amendment and legislative procedures of real-estate related laws. Many development projects have been suspended due to legal bottlenecks, problems in debt refinancing, and funding shortages. The prolonged downturn in the real estate sector will continue to weigh heavily on construction and real estate supply chains.

14. **Although headline inflation has trended down, there remain upside risks to consumer price inflation.** The Organization of the Petroleum Exporting Countries (OPEC) and Russia have recently announced an extension of unilateral production cuts until December, which could tighten supply and push up global fuel prices, in turn adding inflationary pressure to Vietnam's consumer prices. More extreme weather caused by El Niño may also affect agricultural production and cause food prices to spike. Moreover, due to the opposite monetary policy stances of the US and Vietnam, the widening gap between the U.S. and Vietnam interest rates could trigger a sharp depreciation of the Vietnamese dong against the U.S. dollar, adding upward pressure to import and consumer prices as well.

15. **The financial sector is facing a deterioration of asset quality, and there could be a tightening in liquidity conditions.** The banking system's NPL ratio has already increased due to challenges posed by the weak economic conditions (Figure 10). While restructured loans provide temporary relief to borrowers facing cash flow difficulties, they also mask the underlying weak credit quality. The NPL ratio could worsen if the export sector experiences a slowdown or if problems in the real estate market were to escalate,[15] as trade and property-related loans constitute a significant part of banking loan portfolios (Selected Issue 2 – Identifying Vulnerabilities in the Corporate Debt Landscape). Moreover, banks may encounter difficulties in recovering credit losses as the value of pledged collateral would likely have declined, especially when the real estate market is undergoing a major correction (Box B. The Challenge of Non-Performing Loans in Vietnam's Banking Sector). Weak investor confidence may prevent companies from rolling over their debts, thereby heightening difficulties to meet their payment obligations. MSMEs, which have limited access to financing and possess less cash and liquid assets to withstand economic shocks, could become increasingly vulnerable to default. Regarding liquidity risks, amid divergence in the monetary policy directions of the U.S. Federal Reserve and the SBV, the widening interest rate spread between two countries could trigger capital outflows from Vietnam's financial markets and bank deposits[16] as investors seek higher yields abroad.

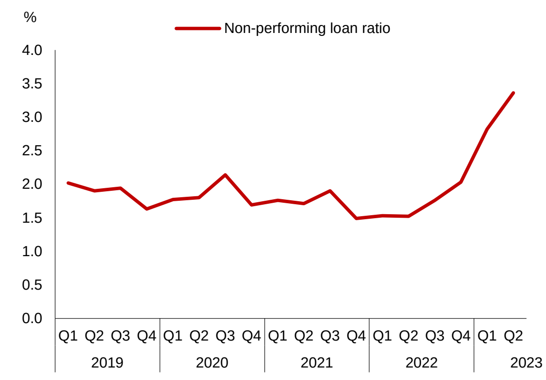
[15] The banking sector has direct lending exposures to the real estate sector, amounting to about 20 percent of the loan books. Vulnerabilities in the real estate sector, if remaining unresolved, could pose systemic risk to financial stability.
[16] The pressure will be more material to U.S. dollar-denominated deposits.

Figure 9. Change in US Retail Sales and Vietnam Manufacturing



Source: U.S. Census Bureau; Vietnam GSO; Haver Analytics; AMRO staff calculations

Figure 10. Bank Sector's NPL Ratio



Source: SBV; CEIC; AMRO staff calculations

Box B. The Challenge of Non-performing Loans in Vietnam's Banking Sector[17]

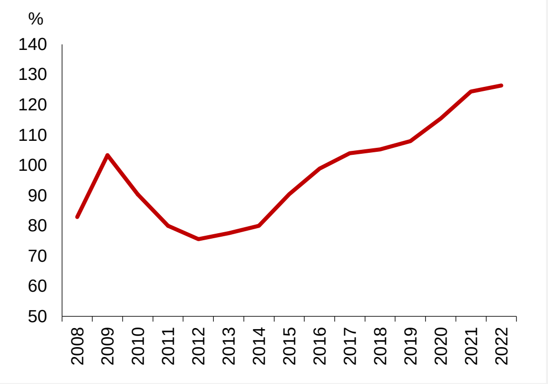
Bank lending has consistently been the dominant form of financing in Vietnam; therefore, effective management of non-performing loans (NPLs) is essential for ensuring financial stability. The current credit-to-GDP ratio in Vietnam has reached a high level, of more than 120 percent by the end of 2022, posing increasing risks to both the banking system and the broader economy (Figure B1). Particularly given current circumstances in which the economy has not yet fully recovered from the COVID-19 pandemic, NPLs are trending upward and could affect other sectors of the economy. This risk underscores the urgency of proactively managing NPLs in the banking sector to mitigate risks and sustain a smooth flow of credit, which is essential for promoting economic growth.

From 2008 to 2010, Vietnam faced challenges due to the global financial crisis and internal economic difficulties, such as high inflation and sluggish growth. Many enterprises were compelled to halt production or face bankruptcy, making it difficult for them to meet loan obligations. At the same time, several commercial banks were pursuing rapid credit expansion to achieve profit targets, even as their capacity to manage credit risk was lagging behind and improving slowly. Consequently, bad debt hit the economy, as the NPL ratio increased from about 2 percent during 2008-2009 to more than 4 percent by 2012 (Figure B2). To address this, the government introduced a "Scheme on Restructuring the Banking System in the 2011-2015 Period" and a "Scheme on Dealing with Bad Debt and establishing the Vietnam Asset Management Company (VAMC)" in 2013. These initiatives gradually curbed the bad debt, bringing it under control and restoring it to a safe level of below 3 percent.

In 2020, the COVID-19 pandemic created new challenges, leading to an increase in bad debt again. To ease the debt burden on businesses, the SBV introduced a debt restructuring program, which kept the NPL ratio under control until the end of 2022. However, the NPL ratio rose again after the policy expired. In April 2023, a new debt relief program was approved to continue to assist businesses during the economic downturn, but the take-up rate has been muted. Amid the downturn of the real estate market, the 2023 NPL ratio has increased sharply to 4.93 percent in September 2023 from 2 percent by the end of 2022, significantly exceeding the safety threshold (Figure B2). The aggregate bad debt ratio is normally 2 percentage points higher than the NPL ratio as the bad debt ratio includes debt that was sold to the VAMC but not yet recovered and contingencies that could become bad debt (such as restructured loans).

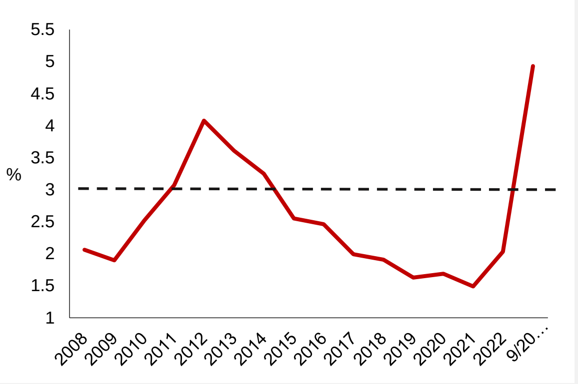
[17] Prepared by Thanh Thuy Giang Dao, Associate.

Figure B1. Domestic Credit to Private Sector as % of GDP



Source: World Bank, CEIC

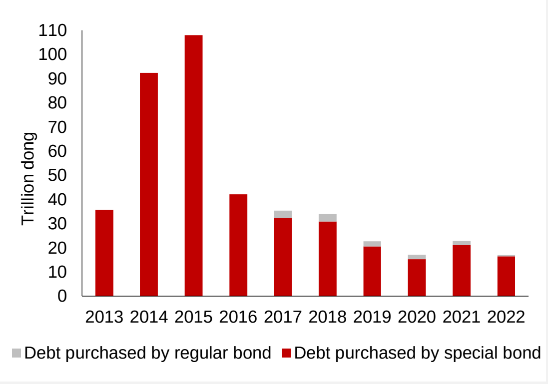
Figure B2. NPL Ratio



Source: SBV, CEIC, AMRO staff compilation

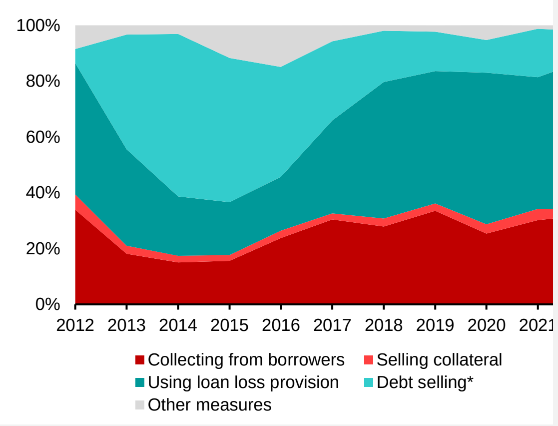
Since the early 2010s, the SBV has continued with its efforts, including by using the VAMC tool and introducing loan restructuring programs[18], to guide credit institutions in managing NPLs. The central bank also encouraged credit institutions to increase provisions to safeguard their financial soundness. Established in 2013, the VAMC was tasked to be a special scheme to rapidly handle bad debt to reduce the NPL ratio to below 3 percent, ensuring the safety of the banking system. During 2013 to 2017, when banks' capacity to address bad debt was limited, the VAMC provided an immediate solution to handling bad debt (Figure B3). It purchased bad debt from credit institutions mostly at book value, while issuing special bonds (if purchasing debt at book value) and regular bonds (if purchasing debt at market value)[19]. Using its specific tools, the VAMC dealt with bad debt by selling debt or collateral. However, credit institutions receiving special bonds had to repurchase bad debt or a part of the bad debt that had not been resolved within five years.

Figure B3: Bad Debt Purchased by VAMC (Represented as Original Principal of the Debt)



Source: SBV, VAMC, AMRO staff compilation

Figure B4: Share of NPL Handling Solutions to Total NPLs Handled.



Source: SBV, AMRO staff compilation
* Debt selling includes debt sold to VAMC and other organizations and individuals

To manage bad debts, credit institutions face challenges in liquidating collaterals. Firstly, the legal framework in Vietnam hinders the smooth enforcement of collateral seizure and liquidation. Secondly, as most collaterals are real estate, the process of transferring ownership during liquidation is often protracted, especially when multiple individuals jointly own the real estate. Additionally, the downturn in the real estate market in recent years has compounded the difficulties associated with collateral sales, including lower liquidation values and challenges in looking for interested investors,

[18] For more details about the loan restructuring program, see Box A Loan Restructuring Programs in Vietnam's Banking Sector
[19] The VAMC started buying bad debt at market value in 2017.

especially when the collateral pertains to an unfinished project that cannot be completed. In 2017, the National Assembly approved Resolution 42, granting the VAMC and credit institutions stronger powers to seize collateral assets. This resolution tried to expedite orders and procedures for resolving collateral disputes in court and prioritized debt obligations over tax obligations when collaterals are liquidated. However, credit institutions continue to encounter difficulties in selling collaterals, leading them to primarily depend on their loan loss provisions for the write-off NPLs (Figure B4). To further facilitate the seizure and liquidation of collateral, most of the regulations outlined in Resolution 42 are incorporated into an upcoming amendment of the Law on Credit Institutions. This amendment has recently been approved by the National Assembly and will take effect from July 2024.

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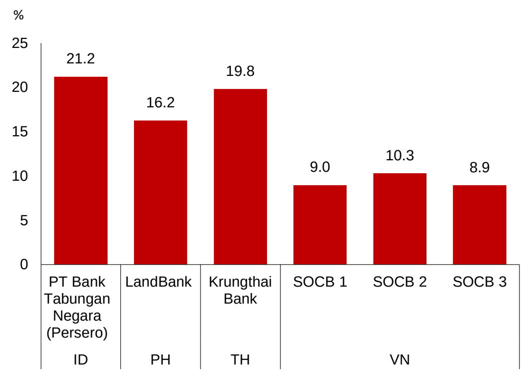
Chi Vu and Quy Tran. 2019 "Addressing the Management of Non-performing Loans in Vietnam: Key Concerns and Suggested Solutions" *Banking Review,* July 19, 2019.

16. **Lingering structural issues in the financial system could pose systemic risks and challenges to market development.**

- In the banking sector, cross holdings between a commercial bank and a non-bank enterprise have become more complex. These cross-ownerships may deepen linkages and cause banks to favour and lend more to certain borrowers or sectors which are related to their shareholders.
- SOCBs are facing constraints in managing retained earnings in order to build up capital buffers (Figure 11). As a result, their lending tends to focus on large enterprises and commercial segments rather than MSMEs, which are riskier and require a higher capital buffer.
- While Vietnam is in the process of deepening its financial markets, a single benchmark policy rate does not exist, which complicates asset pricing and signalling of the country's monetary policy stance.
- A lack of transparency in corporate financial reporting has led to lower confidence in bonds issued via private placement, which will further undermine investor demand. Retail investors also do not have sufficient financial literacy.
- Local MSMEs continue to face difficulty in getting access to financing due to a lack of adequate collateral, transparent and standardized financial statements, and long-term business strategy.

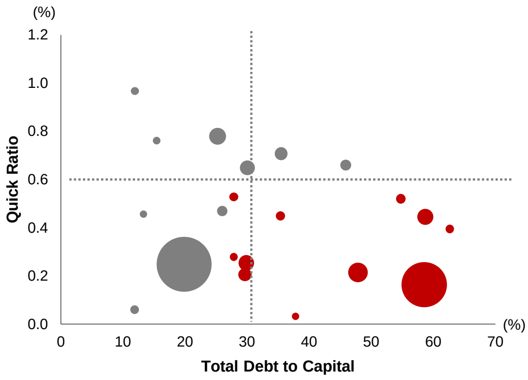
17. **Property developers are struggling to regain financing access, with some facing an increasing risk of insolvency amid the market downturn as structural challenges cloud the market's outlook over the longer horizon.** With many property developers highly leveraged, the housing market downturn has made it more challenging to refinance and secure funding (Figure 12). Looking ahead, as the corporate bond market comes under tighter conditions and greater scrutiny, difficulties in refinancing will likely intensify, increasing solvency risk to developers, especially as legal bottlenecks continue to hamper their ability to liquidate real estate assets. Over the longer term, the sector faces structural challenges, including legal bottlenecks, an oversupply of high-end housing, inconsistencies in the legal framework with regard to land ownership, conversion of land use, property valuation, and extensive cross-ownership between banks and developers. (Box C. Vietnam's Real Estate Puzzle: Facing Challenges)

Figure 11. CAR of State-owned Banks in Vietnam and Selected ASEAN-5 Countries



Source: Moody's; AMRO staff compilation
Note: The banks in this chart are commercial banks partially owned by the government. They are not state-owned policy banks.

Figure 12. Leverage and Liquidity of Property Developers

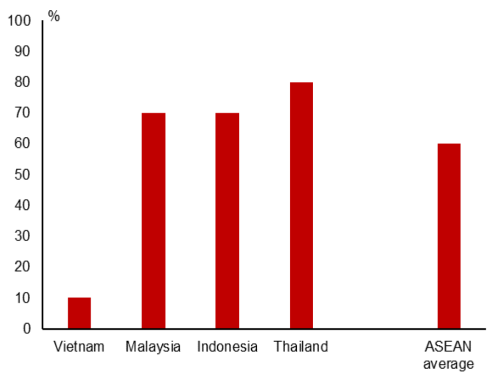


Source: Bloomberg; AMRO staff calculations
Note: The quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets. It is measured as the ratio of current assets minus inventories to current liabilities. The higher the ratio, the better the company's liquidity position. A quick ratio lower than one mean that the company is relying heavily on inventory or other assets to pay its short-term liabilities. The bubble size represents the relative asset size of a developer to the total sample assets. The vertical and horizontal lines represent sample average. Data are as of Q1 2023.

B.2 Longer-term Challenges and Vulnerabilities

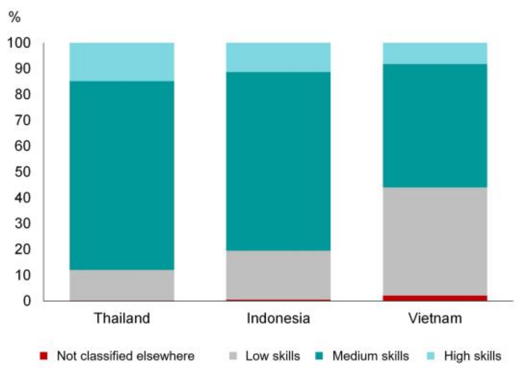
18. **Nurturing MSMEs[20] remains a key structural challenge in the medium to long term.** While Vietnam has been successful in achieving high economic growth over the past decade, much of the success is attributable to multinational corporations (MNCs), which for the most part rely on the country's low-cost labor to assemble final products for export, such as electronics and garments. These MNCs' purported merits of technology transfer have not quite borne out, largely due to MSMEs' inability to produce higher value-added intermediate products of sufficiently good quality to feed into the final products of the MNCs (Figure 13). This reflects MSMEs' difficulties in securing capital to scale up their production and a lack of highly skilled technical labor.

Figure 13. Average Localization Rate Using Example of Automobile Industry



Source: Lam et al. Problem of Multinational Transnational Corporations under Covid-19. SHS Web of Conferences 80, 01003. XVII International

Figure 14. Employment by Labor Skills of Selected ASEAN Countries



Source: International Labour Organization; AMRO staff calculations

[20] Supporting businesses refer to locally owned companies that produce intermediate inputs for sale to MNCs, particularly electronics and auto companies.

Conference of Students and Young Scientists "Prospects of Fundamental Sciences Development" (2020).

19. **Enhancing labor productivity and human resource development is another key challenge facing Vietnam.** As the country strives to switch its growth model from labor-intensive industries to high value-added and capital-intensive sectors, it is grappling with a deficiency in skilled human resources (Figure 14). Many foreign firms have reported problems in hiring mid-level engineering and managerial positions. A mismatch exists between workforce skills and industry requirements. The education and training system has yet to furnish the workforce with the necessary skills and knowledge to meet the demands of a rapidly evolving economy. Although the government has announced action plans to develop human capital, implementation has been slow.

20. **Vietnam is one of the most vulnerable economies to climate risks.** First, geographical features, especially the concentration of economic activities along the long and densely populated coastline, expose Vietnam to typhoons and rising sea levels, making the country highly vulnerable to climate change.[21] Second, Vietnam has witnessed a marked increase in greenhouse gas (GHG) emissions over the past two decades. Electricity demand and GHG emissions have grown more than fivefold during the last 20 years[22] and will continue to increase in the next few decades in line with rapid industrialization and urbanization.[23] Vietnam has committed to phasing out coal power by the 2040s. However, accelerating the country's transition to clean energy can exacerbate power shortages and cause a myriad of problems for energy-intensive manufacturing.

21. The rapidly aging population will start posing challenges to the Vietnamese economy in the next decade. According to the United Nations, Vietnamese people aged 60 and older accounted for 11.9 percent of the total population in 2019 and will rise beyond 25 percent by 2050. By the year 2036, the country is projected to move from an ageing to an aged society due to increased life expectancy[24] and a sharp decline in the fertility rate.[25] With the rapidly aging population would come economic challenges, including a shrinking working-age population, diminishing opportunities for business expansion, reduced tax collection and increased government spending on health care. Moreover, Vietnam needs to strengthen and expand the scope of its social protection system for the elderly to meet fast-growing needs in the medium to long term.

[21] According to the USAID (November 2022), Vietnam is one of the world's top five countries most vulnerable to climate change, especially typhoons, droughts, and landslides along the coastline. The government is strengthening the early forecast system, forest infrastructure and dams to minimize damage caused by physical climate risks.
[22] Source: World Resources Institute Climate Analysis Indicators Tool (CAIT) Climate Data.
[23] The government continues to update its 2020 Nationally Determined Contribution (NDC) to the UN Framework Convention on Climate Change (UNFCCC) and released Decree 06 in January 2022 to draft the 2050 National Climate Change Strategy and design an Emissions Trading System (ETS). The country also approved the Power Development Plan 8 (PDP8) in May 2023.
[24] According to the UN, the life expectancy of Vietnamese people increased from 69.2 years in 1990 to 74.5 years in 2022.
[25] According to the UN, Vietnam's fertility rate fell from 3.6 births per woman in 1990 to 1.94 births in 2022. In other countries of the Association of Southeast Asian Nations (ASEAN), the numbers declined as follows: Singapore, from 1.79 in 1990 to 1.03 in 2022; Thailand, from 2.1 in 1990 to 1.32 in 2022; Malaysia, from 3.37 in 1990 to 1.79 in 2022; Indonesia, from 3.1 in 1990 to 2.2 in 2022; and the Philippines, from 4.35 in 1990 to 2.73 in 2022.

Box C. Vietnam's Real Estate Puzzle: Facing Challenges[26]

The Vietnamese real estate sector has been facing several challenges in recent years. Harmonizing and modernizing the legal framework, tackling financing source constraints, rebalancing product structure, and restoring buyers' purchasing powers are key issues that need to be addressed.

Legal Framework

Harmonizing and modernizing the legal framework are among the foremost challenges. From 2013 to 2020, about 63 percent of the total complaints received by the government were related to land and real estate (Nguyen Le, 2023). Real estate-related laws and regulations have struggled to keep pace with the fast-growing real estate market, resulting in overlaps, complexities, and sometimes conflicts. The legal framework poses a range of issues:

- **Licensing:** The application process to obtain necessary licenses can be lengthy and may require revisions to project plans. Delays can stem from inconsistencies in interpreting regulations or varied processing times at the local level. In addition, because of the government's recent anti-corruption campaign,[27] officials have become more cautious about issuing new licenses to developers.
- **Land Use and Conversion:** Converting land use is a complex process in which local governments are cautious due to various factors such as environmental concerns. Furthermore, complex land classifications and new underregulated property types, such as the condotel,[28] add another layer of delay for developers trying to obtain land use certificates.
- **Land Valuation, Resettlement and Compensation:** The existing land law stipulates a fixed land price bracket. Land prices regulated by the state are only 20-30 percent of market prices (Chinhphu, 2022). As a result, disputes often arise due to unreasonable compensation rates, prolonging the resettlement process.

Financing Source Constraints

Developers face the challenge of raising funds on the bond market and through bank loans. The issuance of outstanding bonds fell substantially at the end of 2022 (Figure C1) due to a significant drop in investor confidence and regulatory crackdowns against market misconduct.[29] Furthermore, project delays due to legal issues have exerted pressure on the earnings of developers, adversely affecting their cash flow. As legal issues also hinder developers from obtaining legal project titles, developers face challenges in fulfilling credit assessments when trying to borrow from banks.

Figure C1. Corporate Bond Issuance by Sector

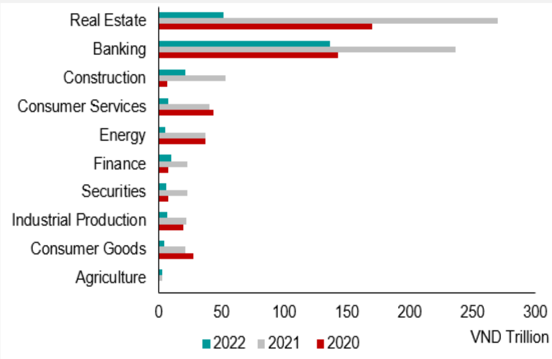
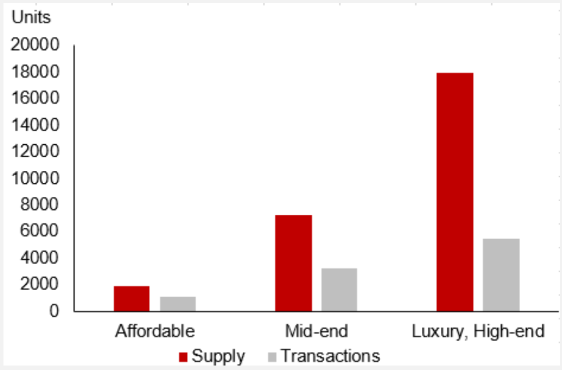


Figure C2. Supply and Transaction by Segment in 2022



[26] Prepared by Trung Thanh Vu, Associate Economist.

[27] Vietnam's anti-corruption campaign is a comprehensive effort by the Communist Party of Vietnam and led to the resignations of many high-ranking government officials in 2022 and 2023.

[28] Condotel refers to a hybrid concept combining elements of a condominium and a hotel. Unlike traditional condominiums, condotel units are managed and operated as hotel rooms.

[29] Certain conglomerates have been implicated in fraudulent activities and accused of defrauding investors concerning corporate bond issuances since 2022. Investigations in these cases are ongoing, leading to substantial erosion of trust among corporate bond investors.

Source: Vietnam Bond Market Association

Source: Vietnam Association of Realtors

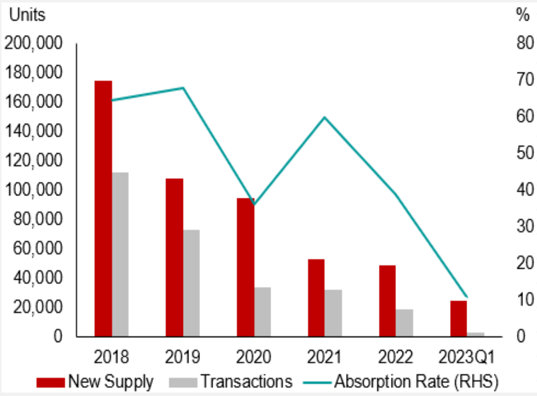
Product Structure

An imbalance in product structure is another challenge. Because of high profit margins, many developers have focused excessively on the high-end and luxury segment, leading to oversupply in this segment (Figure B2). Furthermore, housing prices have become too high compared with people's incomes. Home prices in Ho Chi Minh City are 32.5 times more than the annual household income, while the ratio is 18.3 times in Hanoi, according to the Urban Land Institute.

Purchasing Power of Homebuyers and Investors

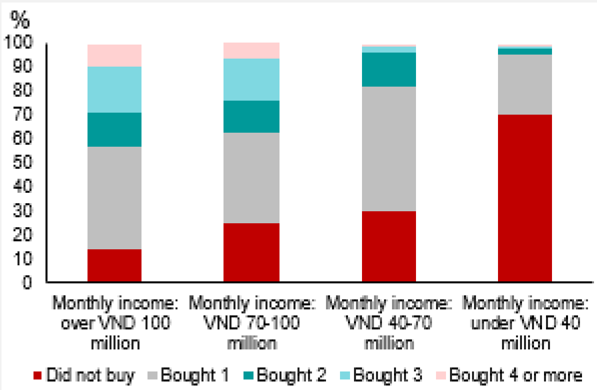
Restoring the purchasing power and confidence of buyers will take time. Amid the market downturn, worsening macroeconomic conditions, and forthcoming law amendments, investors have adopted a wait-and-see approach. As a result, purchasing power has declined significantly (Figure C3). Moreover, most buyers are speculative investors rather than people with real demand for housing. In 2022, homebuyers were mostly high-income earners who bought an additional property rather than their first property (Figure C4).

Figure C3. New Supply and Transactions



Source: Propertyguru and Batdongsan

Figure C4. Number of Purchased Properties by Income in 2022



Source: Propertyguru and Batdongsan

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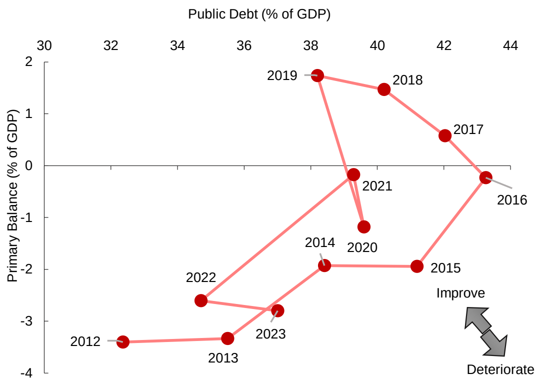
C. Policy Discussions and Recommendations

22. **In light of strong headwinds and financial distress in the residential property market, an appropriate policy mix should be employed to support growth and maintain financial stability while fostering long-term sustainable growth.** Existing support measures should be recalibrated to enhance effectiveness and to provide targeted support for vulnerable groups. These measures should be unwound once economic recovery is back on track. Vietnam has recently experienced rising financial imbalances stemming from the rapid credit growth of real estate developers and speculative demand. Therefore, macroprudential measures should be put in place to pre-emptively safeguard financial stability, considering the significant share of loans to the real estate sector. A concerted effort should be made to promote green, inclusive and sustainable growth as well as to address structural challenges that impede potential growth over the long term.

C.1 Active Role of Fiscal Policy in Bolstering Growth

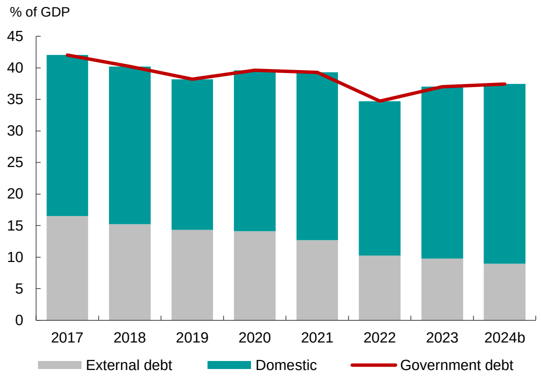
23. **Fiscal policy should play a leading role in bolstering the economy.** With fiscal space still available amid the negative output gap, fiscal policy should offer targeted support to MSMEs and vulnerable households adversely affected by the weak economic conditions (Figures 15, 16). The existing economic stimulus measures are primarily in the form of tax and rental deferrals, which may have limited impact. The measures can be recalibrated and additional measures taken into consideration. For example, uniform tax deductions or tax credits, applied to businesses with total assets or annual sales below a certain threshold, could be introduced to alleviate the burden on smaller businesses during a cyclical downturn. VAT refunds should also be improved and expedited. The social protection system for vulnerable households and informal workers such as unemployment benefits could be temporarily expanded to help vulnerable groups amid weak economic conditions.

Figure 15. Primary Balance and Public Debt



Source: MOF; AMRO staff calculations and projections

Figure 16. Public Debt



Source: MOF; GSO; AMRO staff calculations and projections

24. **Medium-term fiscal policy should aim at improving tax administration, broadening the tax base, enhancing spending efficiency and strengthening social protection.**

- **Revenue:** The AMRO mission commends the government's use of digitalization to streamline administrative processes and enhance tax collection. The authorities should phase out broad-based tax exemptions and tax moratoria. This approach is advisable as extended application of tax exemptions and refunds has the potential to erode the tax base over time. Temporary tax credits can expand the tax base and thus revenue collection over the longer term. To encourage tax payments among MSMEs, it might be worthwhile to provide them some tax incentives[30] and consider a time-bound preferential corporate income tax (CIT) rate for firms that register for the VAT system.
- **Expenditure:** During an economic downturn, the government faces challenges to effectively identify and implement targeted measures. One solution is to strengthen the social protection system, including by introducing conditional cash transfer programs, which would establish a comprehensive and centralized

[30] There is no tax incentives for MSMEs. Like large corporates, SMEs can enjoy corporate income tax incentives (ranging from 10 percent to 17 percent if they can meet the conditions of the tax incentive. Some micro-enterprises and sole proprietors have a flat tax rate, allowing them to pay a fixed amount of tax each year.

database encompassing MSMEs and underprivileged households. Moreover, a delivery or transfer system should be devised to enhance spending capacity, ensuring the efficient transmission of subsidies and support to the intended beneficiaries.

- **Capital investment:**
    - In light of the slow disbursement of public investment due to lengthy administrative procedures, delays in land appropriation and the absence of an assigned budget at the preparatory stage, it is essential to address legal constraints, expedite disbursements and streamline the implementation of public investments.
    - As the country has an infrastructure gap[31] relative to the stage of economic development, capital expenditure should be primarily allocated to improve the quality and availability of infrastructure in transport and information and communications technology (ICT). More budget should be allocated to build green infrastructure and renewable energy.

C.2 Employing Accommodative Monetary Policy While Modernizing Framework

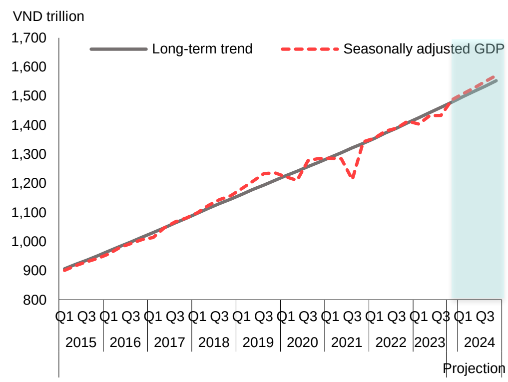
25. **An accommodative monetary policy would offer crucial relief to vulnerable groups and affected sectors, particularly given the subdued inflation.** Although the negative output gap is narrowing, economic uncertainty will likely persist (Figure 17). Consumer price inflation is being effectively controlled through price administration, tax cuts and declining commodity prices. The current accommodative monetary stance has alleviated the financial burden on MSMEs and heavily indebted households, thereby bolstering business and consumer confidence to some extent. However, credit expansion might be constrained due to the uncertain economic outlook. In this context, it is vital to ensure MSMEs have access to financing, and that sufficient funds are available to productive sectors. The approval process of credit support programs should be streamlined, while credit guarantee schemes to vulnerable MSMEs should be enhanced. That said, it is advisable to allow the loan restructuring program to expire once the economy is back on track, to prevent vulnerable borrowers from accumulating more debt. Looking ahead, the negative output gap is expected to close around early next year based on the AMRO baseline assumption. The accommodative monetary policy stance could be gradually normalized once the economic recovery becomes firmer.

26. **Modernization of the monetary policy framework would strengthen the role of monetary policy in supporting the economy.** The AMRO mission commends the SBV's ongoing efforts to modernize monetary policy framework and liberalize interest rates. Considering the rapid pace of economic development, more efforts can be made to improve the transmission mechanism of monetary policy. Regarding the monetary policy framework, ensuring price stability should be the SBV's primary objective to mitigate policy conflicts that might arise from multiple objectives. Moreover, public announcement of the policy target, as well as periodic reports on the conduct of monetary policy and its progress in achieving its target, can help anchor public expectations and enhance the credibility of the central bank. The SBV now has several operating targets – comprising a set of operating interest rates, a credit growth target and an exchange rate trading band – to serve different policy objectives.

[31] According to the Global Infrastructure Hub, Vietnam's infrastructure gap, which is the difference between existing infrastructure investment and the investment the country needs to catch up with its best-performing peers and the UN's Sustainable Development Goals, was around 1.45 percent of GDP in 2023.

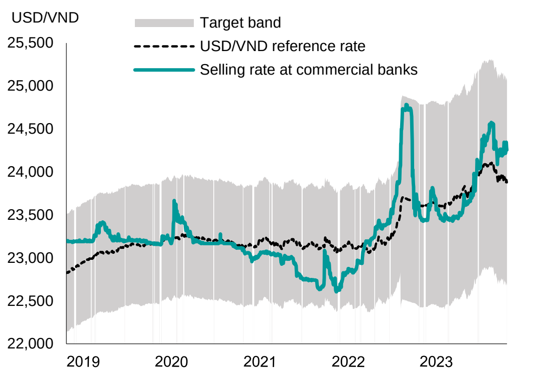
In this regard, the operational targets should be prioritized. The credit growth target should be phased out over time to pave the way toward more market-based policy. As for exchange rate policy, the AMRO mission commends the SBV's gradual shift toward a more market-determined and flexible exchange rate system (Figure 18) by expanding the target band and allowing more flexibility of the FX reference rate.

Figure 17. Forecast GDP and Its Long-term Trend



Source: AMRO staff estimates

Figure 18. Exchange Rate and SBV Exchange Rate Target Band



Source: Vietcombank: SBV; Haver Analytics; AMRO staff calculations

27. **The authorities should consider putting in place a macroprudential policy framework, which would complement monetary and fiscal policies in macroeconomic management.** Expanding macroprudential policy tools would allow the authorities more room to achieve multiple macro-financial objectives. Vietnam has recently experienced rising financial imbalances stemming from the rapid credit growth of real estate developers and speculative demand. Against this backdrop, macroprudential policy can be employed to curb the financial imbalances, while monetary and fiscal policy could continue to support price stability and growth, especially during the growth slowdown. Besides prudential regulations, a new property tax law, including stamp duties or capital gains tax, can also be levied on the purchase of a second and subsequent homes and on foreign buyers to curb speculative demand.

Authorities' views

28. **There is no need to streamline the credit support programs.** Decree No. 31/2022/ND-CP does not impose any additional requirement on conditions, documents, and procedures for interest supported loans compared to regular loans. As stipulated in Clause 1 Article 4, one of the conditions to be met under the Interest Support Program is that the customers satisfy the loan conditions in accordance with the prevailing laws on lending activities of credit institutions and foreign bank branches.

29. **The credit growth target remains an essential policy tool at the current juncture.** Measures to control credit growth in recent times have contributed to controlling inflation at a low level and stabilizing the macroeconomy. At the same time, the credit growth of the credit institution effectively contributes to the economic growth. In the current conditions, as reflected in quite high credit to GDP ratio, the economy's financing needs still depend on the banking system while the capital market is still in the process of development. Therefore, the SBV's credit policies play important role in controlling inflation and supporting sustainable economic growth. Moving forward, the SBV will gradually phase out these measures when conditions permit with an appropriate roadmap.

30. **The merits of a tax on the second or subsequent house in Vietnam should be assessed carefully.** First, a tax on a second or subsequent house may not reduce economic inequality. Second, the implementation remains challenging in Vietnam as the country does not have adequate IT system and centralized database of land and housing market activity. Third, a tax on a second or subsequent house would affect rental prices, which may not be consistent with the Vietnamese government's policy on housing development. Lastly, such taxes may not necessarily limit the speculation in housing and land market from other countries' experiences.

C.3 Safeguarding Financial Stability Alongside Pursuing Regulatory Reform

31. The capital and liquidity buffers of banks should be strengthened to safeguard the soundness of the financial sector against rising credit and liquidity risks. To create stronger safeguards against future shocks, and in view of the expiry of the loan restructuring program, capital and liquidity buffers can be further strengthened. While the banking system is progressing toward full implementation of Basel II standards (Box D. Basel II Adoption and Transformation of Vietnam's Banking Sector), it is also worth considering the introduction of higher quality capital, such as a tier-1 CAR,[32] and additional capital requirements on domestic systemically important banks. Specifically, SOCBs should focus on increasing provisions, capital buffers and liquid assets. The banks should consider raising capital through retaining profits or raising equity. In addition to the total LTD ratio, non-financial institutions and foreign currency LTD ratios should also be monitored to contain liquidity risk.

32. Looking ahead, it is crucial to establish a more formal governance and institutional framework for the banking sector in a few areas. First, to mitigate cross-ownership, the introduction of rules that restrict bank lending to related parties has been well-received, but to ensure their effectiveness, closer supervision and robust governance of bank ownership relationships are essential. Second, mergers and acquisitions between the stronger and weaker banks could be encouraged to leverage economies of scale and strengthen the competitiveness of the merged banks, in addition to improving internal risk control and corporate governance.[33] Lastly, a more structured banking resolution framework should be put in place, to ensure orderly and timely resolution of distressed banks and minimize adverse spillover effects to other stakeholders. The framework should provide clarity on the roles of relevant authorities and the resolution process.

33. **With regard to elevated risks among some property developers, additional efforts should be made to reduce spillover effects to the financial system.** The AMRO mission welcomes the government's timely concerted efforts to address difficulties faced by real estate developers. A series of measures and regulations adopted 2023 could provide immediate relief to developers. Nonetheless, additional actions could be considered.

- Local property developers could diversify funding sources by tapping on equity capital to reduce their high reliance on credit.
- Commercial banks should ensure prudent lending practices for developers, such as lowering lending concentration limits. Implementing macroprudential regulations, including by increasing the risk weights of loans related to real estate

[32] Vietnam could work toward the 2022 average 17.9 percent tier-1 CAR of emerging market and lower-income developing economies in ASEAN, comprising Cambodia, Indonesia, the Philippines and Thailand. The tier-1 CAR of Vietnam was about 9.6 percent in 2022.
[33] Currently, a few weak banks are embarking on mergers and acquisitions, restructuring plans which could increase the scope and competitiveness of banking activities.

activity and imposing statutory loan-to-value and debt-to-income ratios, should also be considered.

- To ensure prudent use of property transaction proceeds, banks must ensure that funds in escrow accounts[34] are withdrawn exclusively for the completion of units, with disbursements linked to the progress of construction.

- In light of developers' tight liquidity with substantial amounts of bonds coming due, loan restructuring such as lengthening of tenure or reduction of interest rates can be considered for viable developers[35] that need short-term liquidity assistance, while consolidation or dissolution may be necessary for unviable developers.

- Corporate governance and transparency should be strengthened by limiting the extent of cross-ownership between banks and developers to restore public confidence in this sector.

Box D. Basel II Adoption and Transformation of Vietnam's Banking Sector[36]

Enforcing the Basel standards that are laid down by the Basel Committee is essential for banks to ensure the safety of their business activities in the face of unpredictable market fluctuations. The implementation of Basel II standards in Vietnam's banking sector, initiated in 2016, is now considered almost complete[37].

The Basel II implementation roadmap involved two key circulars:

- Circular 41/2016/TT-NHNN: Issued by the SBV in 2016, it sets out capital adequacy ratios and offers guidance for Pillar I (the standardized approach) and Pillar III (market discipline and public disclosure) of Basel II. As per the provisions in Circular 41, banks are obligated to satisfy, beyond the capital requirements for credit risk, the capital requirements for market risk and operational risk as well, both of which were previously unregulated. Concerning credit risk, previous regulations had risk-weighted factors ranging from 0 to 150 percent, and Circular 41 expands this to a range of 0 to 250 percent with a more detailed breakdown to accurately reflect the risk associated with each loan and counterparty. In December 2023, the SBV released Circular 22/2023/TT-NHNN, which incorporates amendments and additions to various provisions of Circular 41 to align more closely with international standards.
- Circular 13/2018/TT-NHNN: Introduced by the SBV in 2018, Circular 13 took effect in January 2021. This circular stipulates the bank's internal control system has to align with Pillar II standards on internal capital adequacy assessment process (ICAAP). It mandates the calculation of probability of default, determination of risk appetite, stress testing, internal capital adequacy assessment, and other elements. It also calls for the establishment of three independent lines of defense[38] within the internal control system to identify, control and mitigate risks, as well as the development of internal risk management policies and internal auditing.

[34] An escrow account is a third-party arrangement between developers and property purchasers. The account is meant for an independent party to keep the money safe, to ensure developers do not misuse property transaction proceeds.
[35] Assessment of the viability of firms should adopt a longer-term perspective, considering the ability of the developers to generate sustainable profits and growth over time.
[36] Prepare by Thanh Thuy Giang Dao, Associate.
[37] Except for one joint stock commercial bank
[38] The first line will be performed by the business units, human resources unit, accounting units, and the units with the function of allocating risk limits and identifying, controlling, and minimizing risk. The second line involves compliance department and risk management department to develop risk management policies, internal regulation on risk measurement, monitoring, and legal compliance. The third line refers to the internal audit function.

The implementation plan comprised two phases:

- Phase 1: A pilot run of Basel II began in February 2016, involving 10 commercial banks. These banks aimed to meet Basel II requirement by the end of 2018.
- Phase 2: By 2020, most commercial banks were expected to align with Basel II standards, with at least 12 or 15 of them applying Basel II effectively.

Implementation Outcomes:

Circular 41 mandated that banks achieve compliance with Basel II capital adequacy standards by January 1, 2020. However, several banks faced difficulties adhering to this time limit, primarily due to insufficient capital and challenges in database transition to enable accurate computation of their CARs under Basel II guidance. To address this issue, Circular 22/2019/TT-NHNN extended the implementation process to January 1, 2023, from the initial 2020 deadline. The extension implied banks that were not adequately prepared to adopt Basel II requirements were allowed to continue to calculate their CARs under Basel I guidelines. These guidelines require banks to ascertain a minimum ratio of 9 percent associated with credit risk, rather than involving the combination of credit risk, market risk and operational risk with the minimum requirement of 8 percent according to Basel II.

Despite most banks meeting the Basel II's CAR requirement, by the end of 2022, there remained one state-owned bank (SOCB) and three joint stock commercial banks, which failed to meet the requirements outlined in Circular 41. These banks were classified under "Group of Banks Applied Circular 22". In 2023, the SBV officially acknowledged three out of the four aforementioned banks for achieving full compliance with Basel II requirements. Table D1 shows that, starting from January 2023, the SBV ceased to publish the CAR data of SOCBs under the "Group of Banks Applied Circular 22", implying that all four SOCBs are now in alignment with the Basel II standard for CAR calculation.

Table D1. Average Capital Adequacy Ratio

Category of banks	Average CAR (%)		
	12/2022	**1/2023**	**10/2023**
Group of Banks Applied Circular 41/2016/TT-NHNN (Basel II standard)			
State-owned banks	9.2	9.3	9.6
Joint stock commercial banks	12.0	12.0	12.1
Joint venture, 100% foreign-owned banks, foreign banks' branches	19.2	19.9	20.8
Group of Banks Applied Circular 22/2019/TT-NHNN (Basel I standard)			
State-owned banks	10.6	-	-
Joint stock commercial banks	9.6	9.5	9.4

Source: SBV
Note: The calculation of CAR excluded banks with negative regulatory capital.

SOCBs maintained the lowest average CAR among the various types of banks in Vietnam (Table D1). Increasing their charter capital to attain a higher CAR is challenging as it may affect the state budget. On the other hand, joint stock commercial banks generally enjoyed favorable CARs except for some weaker banks that were slower in achieving the Basel II requirement for CAR computation and were classified as "Group of Banks Applied Circular 22". Compared with domestic banks, foreign-owned and joint-venture banks exhibited significantly high CARs, attributed to their lower risk profiles and substantially higher capital. They adhered to both Vietnamese and home country regulations to ensure their CARs met Basel II standards.

Enhancing CAR for SOCBs

According to prevailing regulations, SOCBs have three main sources of capital raising: retained earnings, capitalization from the state budget, and capital injection from private investors. However, implementation of the third option is challenging as the banks need to find strategic investors. Therefore, SOCBs primarily rely on the first two options to augment their capital. They typically initiate the process by submitting a capital increase proposal to the SBV. The central bank then seeks agreement from the Ministry of Finance and other relevant ministries. Depending on the planned capital sources and the amount of capital injection, the SOCBs' proposal will be forwarded to the government and/or the National Assembly for necessary approval[39]. However, the approval process can be lengthy, thus delaying the increase of SOCBs' capital, which would somewhat maintain their CAR at a lower level and constrain their lending capacity.

34. **The turbulence arising from the housing market also necessitates addressing legal bottlenecks and data gaps related to real estate and construction.** The three important laws that are being amended – the Land Law, the Real Estate Business Law and the Housing Law – would by and large address these legal bottlenecks.[40] Furthermore, it is imperative to harmonize laws, regulations and administrative procedures across all government agencies to ensure clarity, transparency and consistency of the legal framework. Government incentives that facilitate land acquisition can be employed to encourage construction of social housing and affordable homes. While the Ministry of Construction has made progress in developing the real estate database, there is a need to standardize and centralize data on real estate transactions across government agencies, and to develop property price indices. Timely, frequent and granular real estate data will improve market surveillance and policy formulation. To improve surveillance capabilities in the property market, there should be more institutionalized data sharing and policy exchanges between the financial regulatory authorities and relevant ministries.

35. **In the corporate bond market, transparency and financial literacy can be enhanced further.** The resolute enforcement of Decree 65/2022/ND-CP[41] (Box E. Amendment of Regulations on Corporate Bond Issuance (Decree 65)), aimed at enhancing the bond issuance process to require greater information disclosure and impose stricter qualifications and identification on professional investors or high net worth individuals, will play a significant role in restoring investor confidence and promoting sustainable growth of the corporate bond market. The use of credit ratings on bond issuances will help investors to make more informed decisions and enhance the bond pricing mechanism. Greater efforts should also be directed toward education, including financial literacy programs, to empower retail investors to make prudent financial decisions on their own. In light of the mis-selling of financial products, rules on financial consumer protection should be tightened and should require financial brokers or advisers to inform retail clients about the risks associated with investment products.

[39] Regarding capital expansion proposals for the period 2021 - 2023, one SOCB had received the Prime Minister's approval to increase their capital using the retained profits of prior years, while one SOCB had obtained approval from the National Assembly to be allocated additional capital from the state budget. The two remaining SOCBs submitted a capital increase plan to the SBV, and the central bank is currently seeking input from relevant ministries on this matter.

[40] The lingering legal bottlenecks that the law amendments should address are land valuation and ownership, land conversion, compensation, resettlement, information disclosure of real estate businesses, and the management of social housing.

[41] To ease the corporate bond market freeze after the corporate bond turbulence in late 2022, the government issued Decree No. 08/2023/ND-CP on March 5, 2023 to temporarily cease the implementation of Decree 65. Decree 8 allows bond issuers to restructure principal and interest payments, repay maturing bonds with assets other than cash, and defer maturity for two years. In addition, Decree 8 suspended the implementation of new and tightened definition of individual professional investors, the requirement of credit rating of bond issuers, and time limits for distribution of bonds, until January 1, 2024.

Box E. Amendment of Regulations on Corporate Bond Issuance (Decree 65)[42]

Decree 65/2022/ND-CP took effect in September 2022 with the aim of fostering a more transparent and sustainable bond market. Decree 65 serves as an amendment to the existing Decree 153/2020/ND-CP pertaining to the offering and trading of private corporate bonds. The new decree imposes stricter requirements on private-placement issuance and on information disclosure. It also introduces the concept of a centralized bond exchange system for bond registration and trading, which has been operational since June 2023. The key regulatory changes outlined in Decree 65 are as follows:

1. **The use of bond proceeds is restricted.** Bond issuers are no longer allowed to use bond proceeds to increase working capital or to restructure capital resources. Decree 65 requires domestically issued bonds to be used solely for the purpose of restructuring the issuer's debts, implementing investment projects, or conducting other permitted purposes as outlined in applicable laws.

2. **Credit ratings are required to help investors make investment decisions.** Before issuing new bonds, the bond issuer is obligated to obtain a rating from a credit rating agency licensed by the Ministry of Finance (MOF) if:
   - the total par value of bonds issued by the issuer within the 12-month period preceding the issuance date of the new batch exceeds (i) VND500 billion or (ii) 50 percent of the total equity as reported in its most recent financial statement; or,
   - the total par value of outstanding bonds for such issuers at the time of registration for a new issuance surpasses 100 percent of the total equity as stated in its latest financial statement.

3. **The bond issuance process is tightened.**
   - To issue secured bonds, the issuer's underlying assets or collateral must undergo valuation by a third-party appraiser. Additionally, the offering documentation must include the legal status of the underlying assets, security registration, and the payment ranking or order of bondholders at the enforcement of the secured assets.
   - An issuer that intends to issue bonds to individual investors must engage a representative or agent of bondholders. These agents could be a securities custodian or a securities company.

4. **Restrictions on professional investors have been put in place.** A bondholder is prohibited from selling bonds to, or co-investing in bonds with, non-professional securities investors. The decree also outlines criteria for individual professional securities investors (IPSIs). Firstly, a qualified IPSI is required to possess a portfolio of securities worth at least VND2 billion, calculated using the average daily market value of the portfolio over at least 180 consecutive days prior to the calculation date. This calculation excludes the value of margin trading loans and securities in a repo transaction. Secondly, the certification of a qualified IPSI remains valid for only three months.

5. **Bond registration and trading will be centralized.** Before they can be traded, issued bonds are now required to be registered with the Vietnam Securities Depository and Clearing Corporation (VSD), deposited with a securities custodian, and registered for trading on the bond exchange system operated by the Hanoi Stock Exchange. This requirement is more stringent than Decree 153, which only calls for depositing the bonds with a securities custodian. The Bond Exchange started operating in July 2023.

6. **Bond issuers are now subject to more enhanced disclosure requirements.**

[42] Prepared by Thi Thanh Do, Associate (July-December 2022).

- ***Post-issuance disclosure:*** The timeline for disclosing the issuance result is reduced to five business days after completion, down from 10 days.
- ***Unsuccessful issuance or cancellation of bonds***: Issuers must disclose the failure or cancellation of a bond issuance within five days from the end of the bond distribution period.
- ***Periodic reports***: Issuers must submit half-yearly and annual reports on the performance of their commitments to bondholders.
- ***Extraordinary disclosure:*** In addition to requirements stipulated under Decree 153, issuers must disclose any changes to terms and conditions; any changes to the bondholders' representative; a mandatory early redemption; and/or any administrative penalties within 24 hours upon the occurrence of such events.

7. **The SBV and MOF are assigned regulatory and supervisory responsibilities.**

- The SBV, as per Article 4 Clause 2, is responsible for issuing licenses to commercial banks and foreign bank branches that offer underwriting services for corporate bond issuances.
- The MOF, in accordance with Article 42 Clause 3, is tasked with governing and supervising audit organizations and the appraising agency that offers services related to the private placement of corporate bonds.

Due to the turbulence in the corporate bond market, the MOF has decided to postpone the implementation of some requirements of Decree 65, such as tightened qualifications of professional investors and the use of credit ratings, until the end of 2023.

C.4 Fostering Inclusive and Sustainable Growth

36. **Increasing the size and share of private ownership in credit guarantee funds (CGFs) can enhance MSMEs' access to financing.** While CGFs have been operating for more than a decade, a number of challenges have prevented them from being widely used. A key challenge is in the limited size of the funds; their combined charter capital amounts to only around VND1.4 trillion at present. Second, the vast majority of CGFs are local government funds managed by local People's Committees, which lack experience in loan appraisal and hence are often unwilling to provide guarantees due to a fear of criminal prosecution in case of loan default and guarantee activation. Furthermore, complicated procedures for guarantee applications and a lack of transparent financial reporting on the part of MSMEs make it difficult for credit guarantees to be used more widely. Looking ahead, the current structure of provincial CGFs can be modified into a nationwide credit guarantee facility, with capital from both the public sector and commercial banks. To the extent that bank ownership increases, banks will be more incentivized to take a bigger role in the administration of credit guarantees, which will likely enhance their operational performance due to greater experience in loan appraisal and management, and lead to higher provision of credit guarantee to MSMEs (Selected Issue 3. Financial Support for SMEs: Credit Guarantee Schemes and SME Development Fund).

37. **The policy for human capital development should ensure that the quality and supply of the workforce are aligned with business needs, while also nurturing the growth of mid and high-quality labor.** Greater efforts[43] and financial support should be implemented to increase the availability and quality of vocational training and educational programs. It is also essential to strengthen educational systems to develop soft skills for students and emphasize technical subjects such as Science, Technology, Engineering, and Mathematics (STEM) to prepare students for technology-driven industries. Moreover,

[43] The government has announced action plans to strengthen human resource development, including Decision 176/QD-TTg on a program to support labor market development until 2030, and Decision 2239/QD-TTg on a strategy to develop vocational education during 2021-2030 with a vision to 2045. However, stronger implementation of these action plans is needed.

collaboration[44] among universities, research institutions and businesses should be strengthened to help transfer knowledge and technology. Lastly, initiatives to attract and retain talent should encompass improvements in working conditions, competitive salaries and benefits, as well as greater access to health care and social security benefits.

38. **To strengthen the country's climate resilience, greater attention should be paid to transition risk management and fiscal sustainability.** Climate change policy measures should be developed constantly to minimize transition risks while working toward a low-carbon economy. In addition, the authorities should prioritize fiscal soundness and feasibility in designing an energy transition road map.[45] It is also critical to establish a safety net for vulnerable groups and sectors that takes into account the uneven distributional impacts of a low-carbon economy, including higher fuel prices. Careful consideration should be given to impacts that low-carbon policy measures might have on the fiscal position. Mobilizing private-sector money is also crucial in achieving the much-needed investment. In this regard, the draft Direct Power Purchase Agreement on a pilot scheme in 2022 is an important step forward. Looking ahead, a green economy is becoming a driver of growth. MNCs and consumers are shifting toward low-carbon markets and products. The government should continue to accelerate the Vietnam Green Growth Strategy to scale up deployment of green technologies, improve the efficiency of the economy and drive economic growth in a sustainable manner.

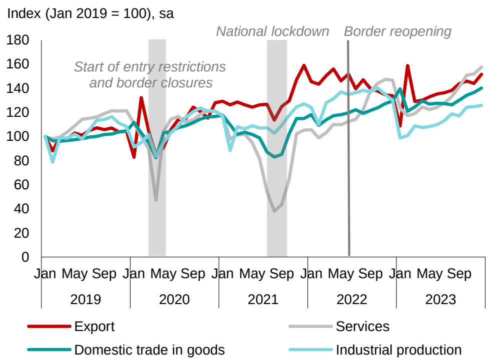
[44] Collaborative models should be promoted, such as those between the Foreign Trade University and Can Tho University with local companies under support from the Japan International Cooperation Agency.
[45] According to the World Bank, Vietnam is expected to need additional investments equivalent to about 6.8 percent of GDP per year, or a cumulative USD368 billion through 2040.

Appendices

Appendix 1. Selected Figures for Major Economic Indicators

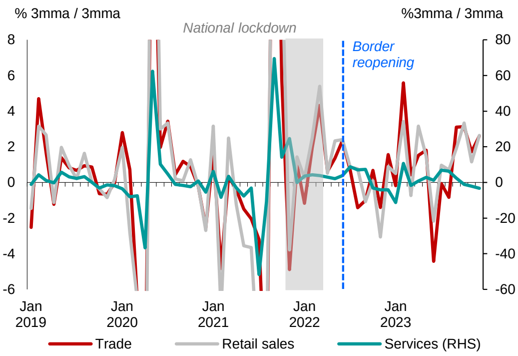
Figure 1. Real Sector

Overall external and domestic demand has yet to recover.



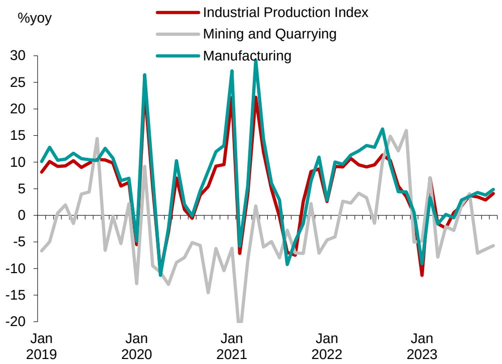
Source: GSO; CEIC; AMRO staff estimates

Domestic retail sales have not shown a firm recovery.



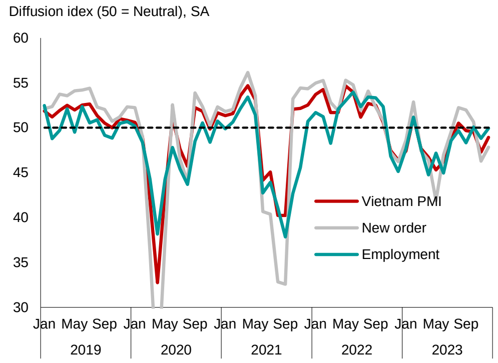
Source: GSO; CEIC; AMRO staff calculations

Industial production, especially manufacturing, is seeing sings of bottoming out.



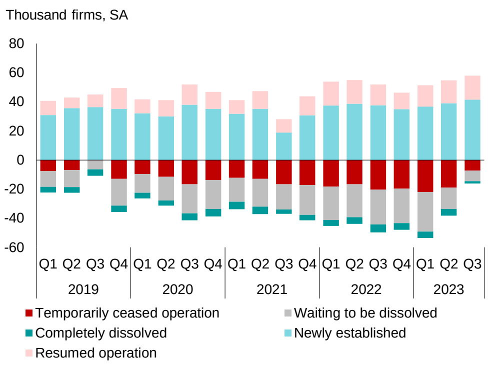
Source: S&P Global Market Intelligence via Haver Analytics

Business sentiment has improved slightly since August 2023, thanks to a recovery in new orders.



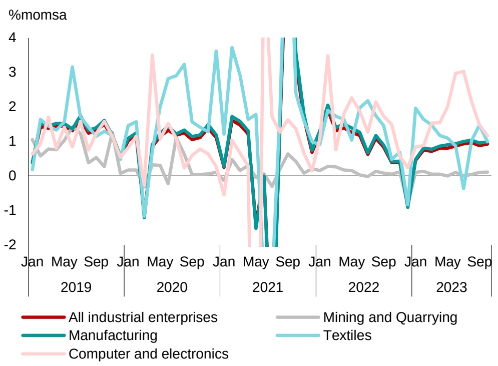
Source: S&P Global; CEIC; AMRO staff calculations

The number of new firms has inched up, while the number of dissolved frims has dropped.



Source: GSO; CEIC

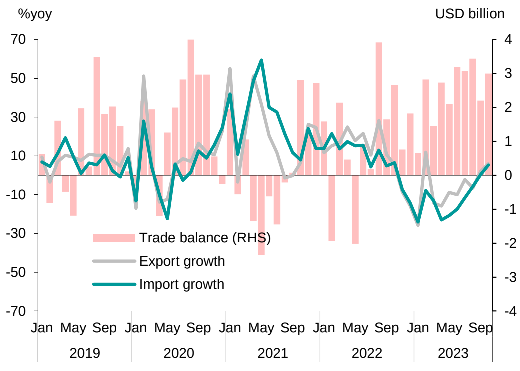
Employment has improved grudually.



Source: GSO; CEIC; AMRO staff calculations

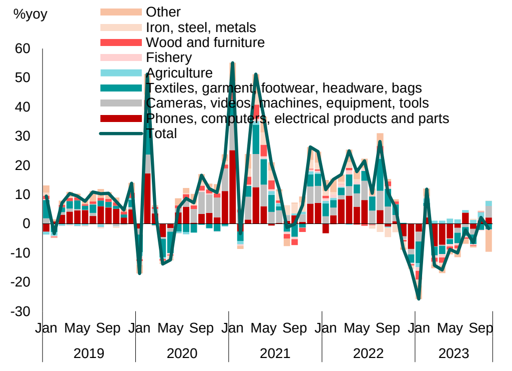
Figure 2. External Sector

In 2023, the trade surplus was strong, primarily due to import compression.



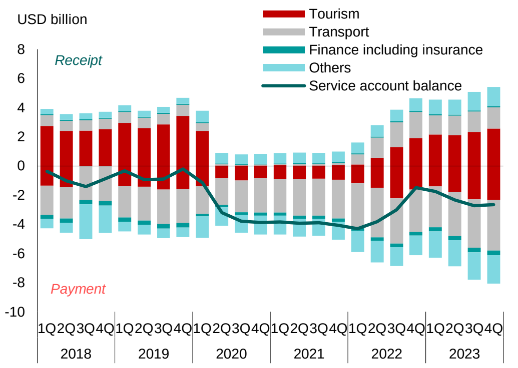
Source: SBV; CEIC; AMRO staff calculations

Exports plunged across all products, except agricultural goods.



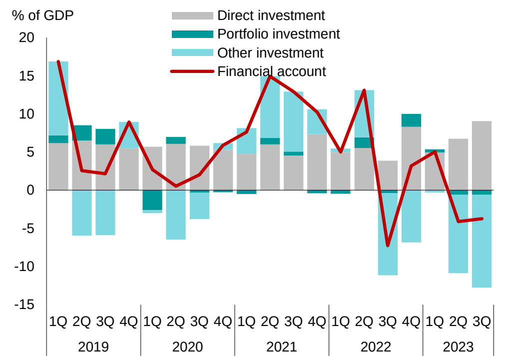
Source: GSO; CEIC; AMRO staff calculations

The service account has been normalizing as tourism income recovered.



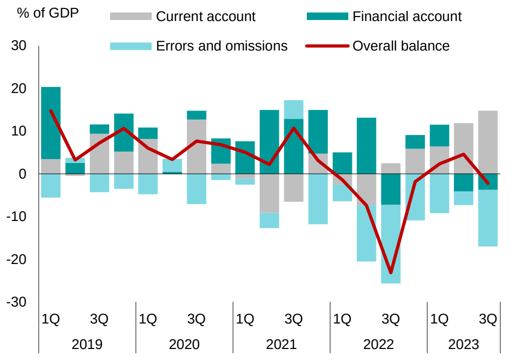
Source: SBV; CEIC; AMRO staff calculations

Amid dong depreciation, the country saw outflows of FX currency and deposits.



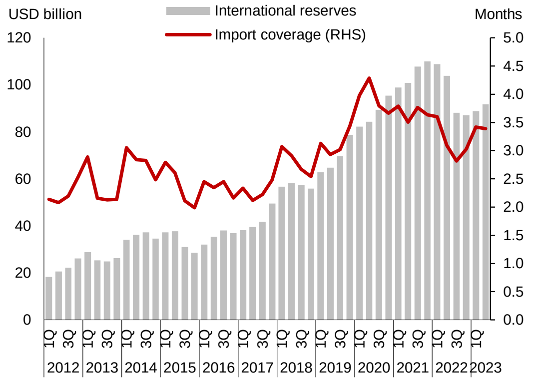
Source: SBV; CEIC; AMRO staff calculations

Despite sizable financial outflows, the BOP remained in a surplus due to the trade surplus and resilent FDI.



Source: SBV; CEIC; AMRO staff estimates

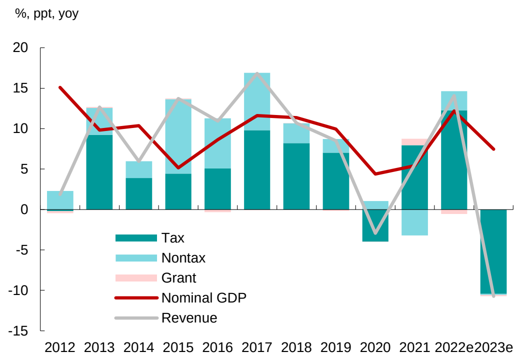
Foreign reserves covered more than three months of imports, or 2.76 times short-term external debt.



Source: SBV; GSO; World Bank; CEIC; AMRO staff calculations

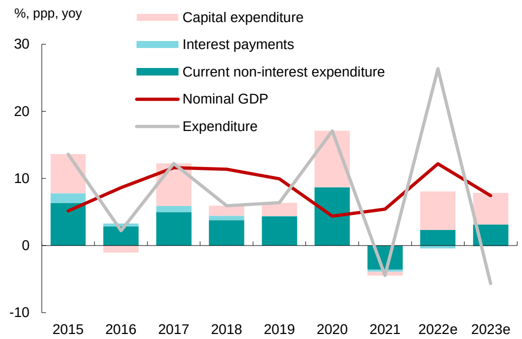
Figure 3. Fiscal Sector

In 2023, revenue declined due to the economic slowdown.



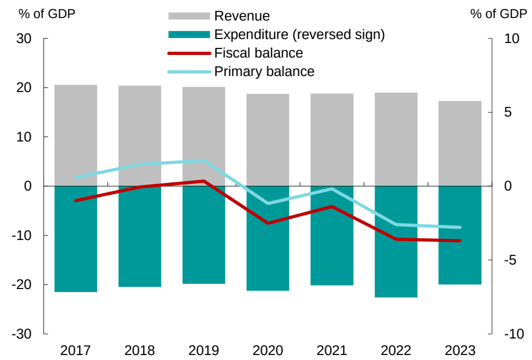
Source: MOF; AMRO staff calculations

A reduced budget resulted in less expenditure.



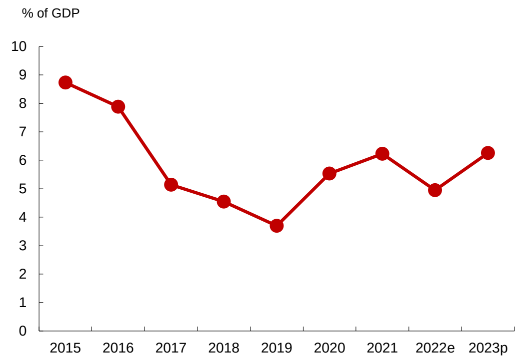
Source: MOF; Haver Analytics; AMRO calculations

Fiscal deficit in 2023 is estimated to stay flat at 3.7 percent of GDP.



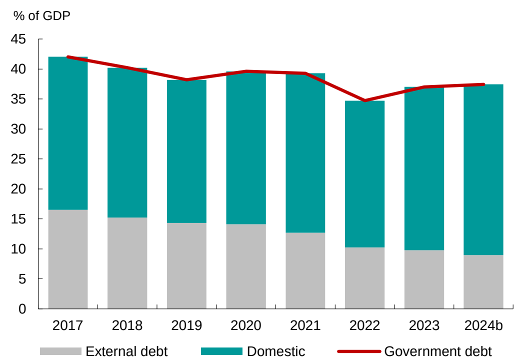
Source: MOF; Haver Analytics; AMRO estimates

… pushing up gross financing needs.



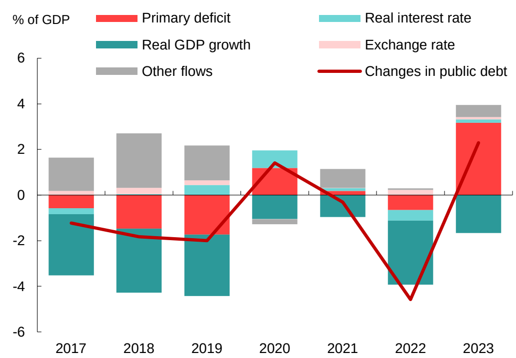
Source: MOF; Haver Analytics; AMRO calculations
Note: 'e' stands for estimation. The fiscal balance in 2022 is based on MOF's estimation. 'p' stands for AMRO staff's projection.

The public debt-to-GDP ratio is expected to inch up…



Source: MOF; Haver Analytics; AMRO forecasts

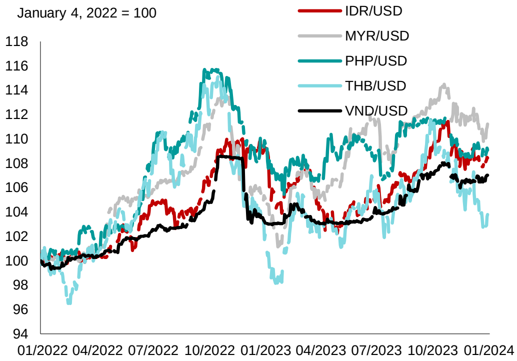
… on the back of the widening primary account deficit.



Source: MOF; Haver Analytics; AMRO calculations

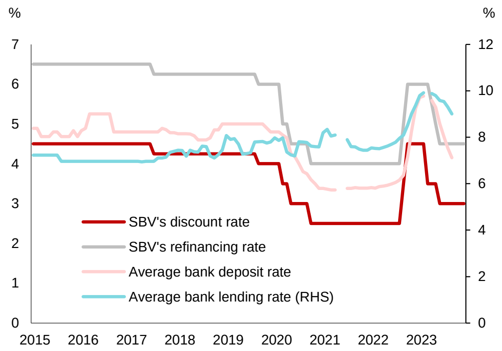
Figure 4. Monetary Sector

The dong generally depreciated against the US dollar in 2023.



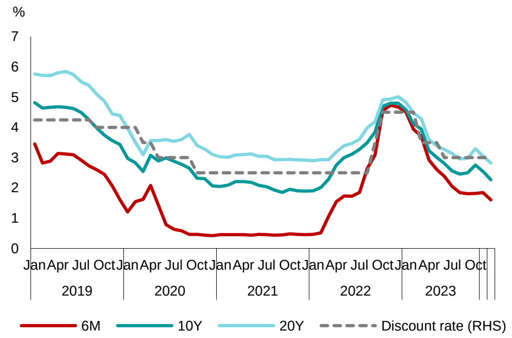
Source: Vietcombank; CEIC; AMRO staff calculations

With inflation under control and the dong stable in Q1, the SBV cut operating rates to stimulate growth.



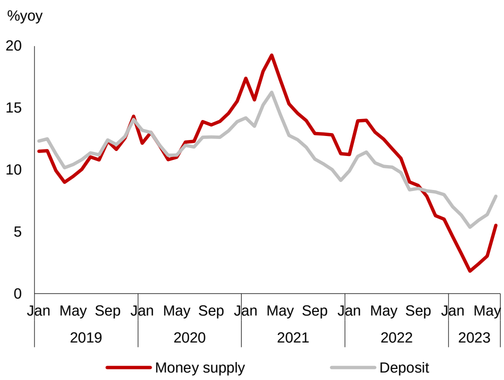
Source: SBV; CEIC

Government bond yields have declined accordingly.



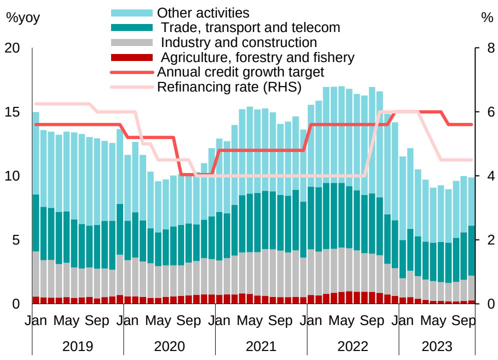
Source: HNX; SBV; CEIC

Money supply growth softns due to weak loan demand.



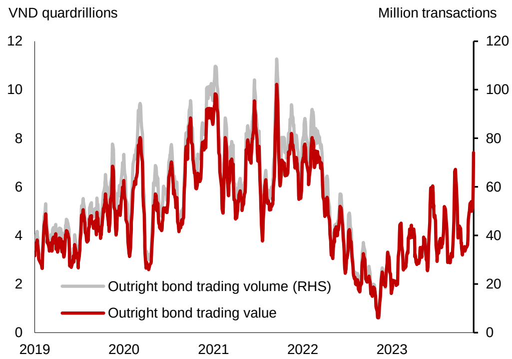
Source: SBV; CEIC; AMRO staff calculations

Loan demand and credit growth softened.



Source: SBV; CEIC; AMRO staff calculations

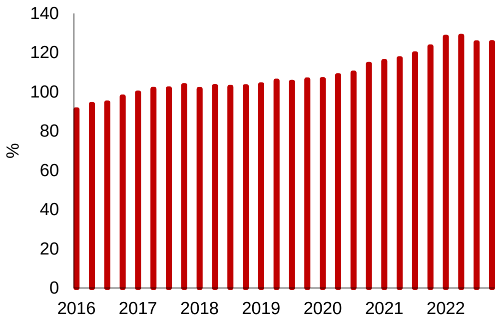
Investment sentiment in the corporate bond market has gradually improved.



Source: HNX; CEIC

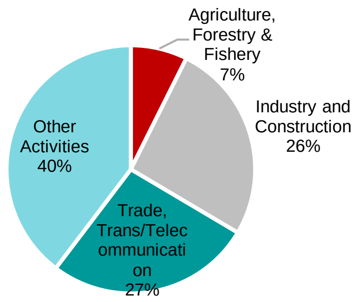
Figure 5. Financial Sector

The credit-to-GDP ratio has declined.



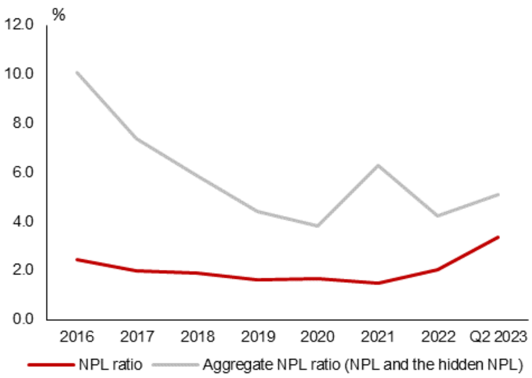
Sources: SBV via Haver Analytics; AMRO staff calculations

Most of the current banking credit is in trade, industry and construction.



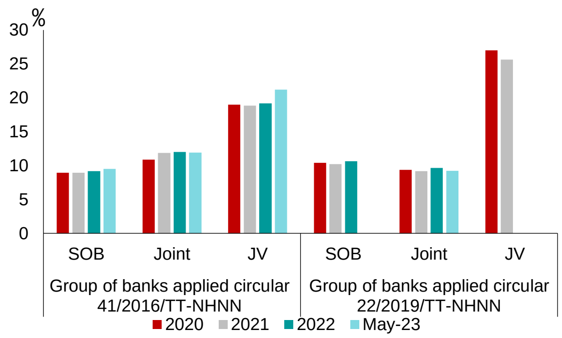
Sources: SBV via Haver Analytics; AMRO staff calculations

The NPL ratio has increased on the back of the challenging economic environment.



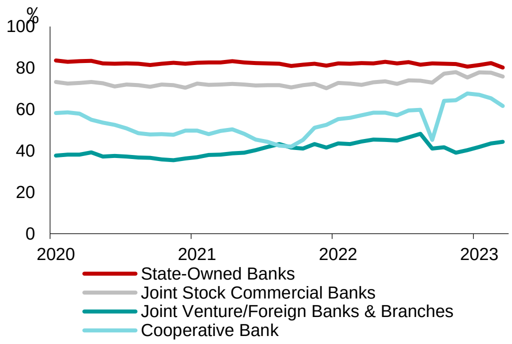
Sources: SBV via Haver Analytics; AMRO staff calculations

Total CARs of banks have risen to better cushion against adverse shocks.



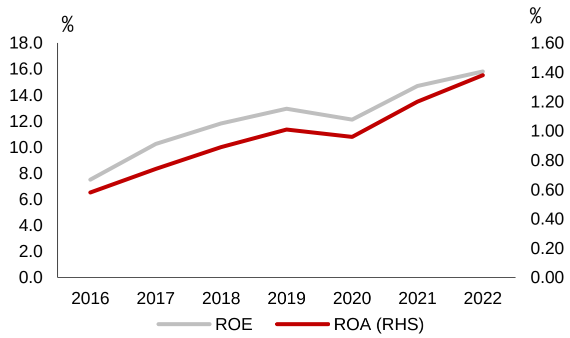
Sources SBV via Haver Analytics
Note: SOB, Joint, and JV refer to state-owned banks, joint stock commercial banks, and joint ventures and 100 percent foreign-owned banks, respectively[46].

LTD ratios are below 100 percent but are higher for larger banks.



Source: SBV via Haver Analytics

Bank profitability, such as ROE and ROA, has continued to increase.



Source: SBV via Haver Analytics

[46] Circular 41 requires credit institutions to comply with CAR regulations in accordance with Basel II standards by January 1, 2020. However, some credit institutions faced challenges during implementation, leading the SBV to issue Circular 22, which granted those credit institutions an extension for the adoption of Basel II capital standards until 2023.

Appendix 2. Selected Economic Indicators for Vietnam

	2019	2020	2021	2022	Projections 2023	Projections 2024
National income and prices	(In annual percentage change, unless otherwise specified)					
Real GDP	7.4	2.9	2.6	8.0	4.7	6.0
Consumer price inflation	2.8	3.2	1.8	3.2	3.3	3.4
Core inflation	2.0	2.3	0.8	2.6	4.2	3.6
Balance of payments	(In billions of U.S. dollars, unless otherwise specified)					
Current account balance	12.2	15.1	-8.1	-1.1	19.5	9.9
In percent of GDP	3.6	4.3	-2.2	-0.3	4.5	2.1
Trade balance	21.2	30.7	15.7	25.7	29.8	20.4
In percent of GDP	6.3	8.9	4.3	6.3	6.9	4.3
Service balance	-2.4	-10.3	-15.7	-12.5	-3.8	-3.9
Primary income	-15.3	-14.8	-16.1	-18.8	-14.9	-15.4
Secondary income	9.2	9.5	10.3	6.7	8.4	8.8
Financial and capital account balance	19.0	8.5	30.8	9.5	3.0	7.6
In percent of GDP	*5.7*	*2.4*	*8.4*	*2.3*	*0.7*	*1.6*
Direct investment, net	15.7	15.4	15.3	15.2	15.5	15.6
Portfolio investment, net	3.0	-1.3	0.3	1.5	0.5	2.0
Other investment, net	0.3	-5.7	15.3	-7.3	-13.0	-10.0
Net errors and omissions	-7.9	-6.9	-8.4	-31.1	-16.2	-8.5
Overall balance	23.3	16.6	14.3	-22.7	6.3	9.0
Gross international reserves	78.8	95.5	110.0	87.2	93.6	102.6
In months of imports of goods & services	3.6	4.2	3.9	2.8	3.2	3.3
Coverage of short-term debt	3.2	3.6	3.3	2.8	2.8	2.4
Total external debt/GDP	35.1	36.1	37.2	35.6	36.1	34.9
Short-term/total external debt	20.8	21.3	24.4	21.6	21.6	25.9
General government	(In percent of GDP)					
Revenue and grants	20.2	18.8	16.1	17.0	17.0	15.9
Expenditure	19.8	21.3	20.2	21.4	20.6	18.9
Overall balance	0.3	-3.5	-1.4	-3.6	-3.7	-3.0
Public debt	38.2	39.6	39.3	34.7	37.0	35.1
Monetary sector	(In annual percentage change unless otherwise specified)					
Domestic private credit	12.8	11.6	13.5	14.0	10.8	13.2
In percent of GDP	111.4	120.0	128.2	127.3	136.1	136.4
Broad money	13.6	13.6	9.7	5.7	17.2	10.5
Memorandum items:						
Exchange rate (USD/VND), period average	23,051	23,208	23,160	23,271	…	…
Exchange rate (USD/VND), end of period	23,155	23,131	23,145	23,612	…	…
Nominal GDP in billions of USD	334.4	346.6	366.1	408.8	432.2	477.6
Nominal GDP in trillions of VND	7,707	8,044	8,480	9,513	10,138.9	11,202.6

Source: Data provided by the Vietnamese authorities; AMRO staff estimates
Note: 1/ The pre-2021 public debt-to-GDP ratio is computed based on the recalibrated GDP figures released since 2021.

Appendix 3. Balance of Payments

	2019	2020	2021	2022	Projections	
					2023	2024
	(In billions of U.S. dollars, unless otherwise specified)					
Current account balance	12.5	15.1	-8.1	-1.1	-4.3	0.6
Trade balance	10.6	19.8	3.3	12.4	7.7	15.1
Exports of goods	264.3	282.6	336.2	371.3	322.6	367.8
Imports of goods	253.7	262.8	332.9	358.9	314.9	352.7
Services account balance	-0.9	-10.3	-15.7	-12.6	-4.0	-5.1
Exports of services	16.6	7.6	4.2	12.9	15.0	13.1
Imports of services	19.0	17.9	19.9	25.5	19.0	18.2
Primary income balance	-16.8	-14.8	-16.7	-19.7	-16.5	-17.4
Secondaray income balance	9.2	9.5	10.3	5.6	8.4	8.0
Financial account balance	19.0	8.5	30.8	9.5	15.3	13.2
Direct Investment: Net	15.7	15.4	15.3	15.2	19.0	16.0
Portfolio Investment: Net	3.0	-1.3	0.3	1.5	0.8	-0.3
Other Investment: Net	0.3	-5.7	15.3	-7.3	-4.5	-2.5
Net Errors & Omissions	-8.2	-6.9	-8.4	-31.1	-8.5	-6.0
Overall Balance	23.3	16.6	14.3	-22.7	2.5	7.8
Gross international reserves	78.8	95.5	110.0	87.2	89.7	97.5
	(In percent of GDP)					
Current account	3.7	4.3	-2.2	-0.3	-1.0	0.1
Trade balance	3.2	5.7	0.9	3.0	1.8	3.2
Financial account	5.7	2.4	8.4	2.3	3.6	2.8
Direct investment	4.7	4.4	4.2	3.7	4.4	3.4
Portfolio Investment	0.9	-0.4	0.1	0.4	0.2	-0.1
Other Investment	0.1	-1.6	4.2	-1.8	-1.0	-0.5
Net Errors & Omissions	-2.5	-2.0	-2.3	-7.6	-2.0	-1.3
Overall balance	7.0	4.8	3.9	-5.6	0.6	1.7
External debt	36.6	37.3	38.2	35.9	36.3	35.1
Short term debt	7.3	7.7	9.1	9.3	7.6	8.8
Medium-to-long term debt	29.2	29.5	28.6	26.1	28.7	26.3

Source: Data provided by the Vietnamese authorities; AMRO staff estimates

Appendix 4. Statement of General Government Operations

	2019	2020	2021	2022	Projection	
	Final	Final	Final	Est	2023	2024
	(In trillions of Vietnamese dong, unless otherwise specified)					
Revenue and grants (1)	**1,554**	**1,511**	**1,366**	**1,614**	**1,719**	**1,779**
Tax revenue	1,122	1,056	1,055	1,224	1,281	1,513
Value Added Tax	363	340	333	390	348	507
Corporate Income Tax	271	257	273	302	344	383
Individual Income Tax	109	115	113	146	157	175
Excise Tax	107	100	98	115	119	130
Import & Export Tax	97	79	87	115	116	116
Other taxes	142	128	151	156	196	203
Non tax revenue	426	450	302	383	454	478
Grants	5	5	8	8	6	6
Expenditure (2)	**1,527**	**1,710**	**1,709**	**2,035**	**2,090**	**2,119**
Current expenditure	1,105	1,133	1,196	1,223	1,292	1,356
Interest	107	106	106	100	102.9	103.5
Other current expenditure	998	1,027	1,090	1,124	1,189	1,273
Capital expenditure	422	576	490	663	827	951
Principal payment	188	222	243	198	160.6	182.6
Overall balance	**26.7**	**-198.9**	**-343.7**	**-421.3**	**-370.5**	**-340.2**
Primary balance	133.8	-92.5	-237.8	-321.6	-267.6	-236.7
	(In percent of GDP, unless otherwise specified)					
Revenue and grants (1)	20.2	18.8	16.1	17.0	17.0	15.9
Tax revenue	14.6	13.1	12.4	12.9	12.6	13.5
Value Added Tax	4.7	4.2	3.9	4.1	3.4	4.5
Corporate Income Tax	3.5	3.2	3.2	3.2	3.4	3.4
Individual Income Tax	1.4	1.4	1.3	1.5	1.6	1.6
Excise Tax	1.4	1.2	1.2	1.2	1.2	1.2
Import & Export Tax	1.3	1.0	1.0	1.2	1.1	1.0
Other taxes	1.8	1.6	1.8	1.6	1.9	1.8
Non tax revenue	5.5	5.6	3.6	4.0	4.5	4.3
Grants	0.1	0.1	0.1	0.1	0.1	0.0
Expenditure (2)	19.8	21.3	20.2	21.4	20.6	18.9
Current expenditure	14.3	14.1	14.1	12.9	12.7	12.1
Capital expenditure	5.5	7.2	5.8	7.0	8.2	8.5
Overall balance	0.3	-3.5	-1.4	-3.6	-3.7	-3.0
Primary balance	1.7	-2.1	-0.2	-2.6	-2.6	-2.1
Public debt	38.2	39.6	39.3	34.7	37.0	35.1
Domestic debt	23.9	25.5	26.6	24.5	27.2	26.0
External debt	14.3	14.1	12.7	10.2	9.8	9.1
Memorandum items:						
Interst payment / Current expenditure (%)	9.7	9.4	8.9	8.1		
Interest payment / State revenue (%): ICR	6.9	7.1	7.8	6.2		
Pincipal and interest payment / State revenue (%): DSR	19.1	21.8	25.7	18.5		
Effective interest rate	4.3	4.1	3.5	3.2		

Source: Data provided by the Vietnamese authorities; AMRO staff estimates
Note: 1/ The pre-2021 public debt-to-GDP ratio is computed based on the recalibrated GDP figures released since 2021.

Appendix 5. Climate Change Policy Fact Sheet [47]

<table>
<tr><th>Item</th><th>Sub-item</th><th colspan="5">Note</th></tr>
<tr><td rowspan="16">Nationally Determined Contribution (NDC)</td><td>Submission</td><td colspan="5">• Vietnam updated its NDC in October 2022.</td></tr>
<tr><td rowspan="5">GHG emission reduction targets by 2030</td><td colspan="5">• Total emissions of greenhouse gases (GHGs) in 2020 amounted to 528.4 million tonnes of carbon dioxide equivalent (MtCO2eq).
• The government provides three scenarios to analyze projected GHG emissions under three scenarios: business-as-usual (BAU), unconditional mitigation and conditional mitigation.
• The BAU scenario was developed based on the assumption of economic growth in the absence of climate change response policies.
• Unconditional mitigation aims to reduce total GHG emissions by 15.8 percent by 2030 compared with the BAU level, equivalent to 146.3 MtCO2eq, through the use of the state budget, loans, investments from domestic and foreign enterprises, and citizen contributions and investments.
• Conditional mitigation aims to reduce total GHG emissions by 43.5 percent by 2030 compared with BAU, equivalent to 403.7 MtCO2eq, with international financing.</td></tr>
<tr><td colspan="2">(Units: MtCO2eq, USD billion)</td><td>2020</td><td>2030</td><td>Financial needs</td></tr>
<tr><td colspan="2">BAU</td><td>528.4</td><td>927.9</td><td>-</td></tr>
<tr><td colspan="2">Unconditional</td><td>443.4</td><td>781.6 (-146.3)</td><td>21.7</td></tr>
<tr><td colspan="2">Conditional</td><td>443.4</td><td>524.2 (-403.7)</td><td>86.8</td></tr>
<tr><td rowspan="6">Mitigation</td><td>5 Sectors</td><td>Key subsectors</td><td>Unconditional GHG reduction of total 146.3 (ktCO2eq)</td><td>Conditional GHG reduction of total 403.7 (ktCO2eq)</td><td>Financial needs out of total 21.7 / 86.8 (USD billion)</td></tr>
<tr><td>Energy</td><td>Energy industry
Industrial production
Construction
Transport
Households
Services
Trade</td><td>64.8</td><td>227.0</td><td>Unconditional 14.5
/
Conditional 60.6</td></tr>
<tr><td>Agriculture</td><td>Rumen digestion
Organic fertilizer management
Rice cultivation</td><td>12.4</td><td>50.9</td><td>2.1 / 16.1</td></tr>
<tr><td>Land use, land-use change and forestry</td><td>Forest land
Cultivated land
Grassland</td><td>32.5</td><td>46.6</td><td>3.9 / 5.5</td></tr>
<tr><td>Waste</td><td>Landfills
Materials production from solid waste
Domestic and industrial wastewater treatment</td><td>8.7</td><td>29.4</td><td>0.9 / 2.7</td></tr>
<tr><td>Industrial processes</td><td>Construction materials
Chemical industry
Hydrofluorocarbon consumption</td><td>27.9</td><td>49.8</td><td>0.3 / 2.0</td></tr>
<tr><td rowspan="2">Adaptation</td><td>Scenario of high climate change</td><td colspan="4">▪ Temperature: annual increase of 1.7-2.3ºC by 2050, 3.2-4.2ºC by 2100
▪ Rainfall: annual increase of 10-15 percent by 2050, 10-25 percent by 2100
▪ Sea level: average rise of 73cm along Vietnam’s entire coastline by 2100</td></tr>
<tr><td>Loss and damage</td><td colspan="4">▪ 2011-2020: VND229,958 billion (USD10 billion), 3.2 percent of GDP
▪ 2021-2030: Temperature increases of 1.0ºC and 1.5ºC could cause losses of 1.8 percent and 4.5 percent of GDP, respectively. If sea levels rise according</td></tr>
</table>

[47] Prepared by Sungtaek Kwon, Senior Economist.

			to the scenario of high climate change, 3.1 million people will have to relocate domestically by 2050.
		Adaptation policy measures	▪ Putting in place climate monitoring and early warning of natural disasters ▪ Planning a natural disaster response, flood prevention for major cities, reinforcement of river dikes and sea dikes, and reservoir safety ▪ Ensuring food and water security ▪ Building climate-resilient communities ▪ Protecting and sustainably developing forests and preserving bio-diversity
Climate Finance	Financial needs	(NDC) • To realize unconditional and conditional contributions that aim to reduce GHG emissions by 15.8 percent and 43.5 percent by 2030 over the BAU level, Vietnam's incremental financing needs are USD21.7 billion and USD86.8 billion, respectively. • The financing needs of climate change adaptation for 2021-2030 are estimated to exceed 3-5 percent of 2020 GDP, equivalent to between USD55 billion and USD92 billion according to the 2020 net present value at a 10 percent discount. (World Bank) • Pursuing a combined mitigation and adaptation approach is estimated to require additional investment of about 6.8 percent of GDP per year for 2022-2040, equivalent to USD368 billion according to the 2022 net present value at a 6 percent discount.	
	Resources	• Funding from the state budget, with a focus on capital sources from public investment plans and regular spending on programs, schemes, projects and tasks about the climate change response. • Loans and funding from domestic and foreign businesses and individuals. Cooperation between the public and private sectors, and between domestic and foreign investors in climate change response programs and projects. • Funding from financial institutions, funds and international private investors, concessional loans and official development assistance. Technical assistance from countries and from international organizations and non-governmental organizations that are responding to climate change. • Financial resources, technology and capacity building under bilateral and multilateral international cooperation mechanisms, especially within the frameworks of the UNFCCC and Paris Agreement. • Financing through carbon market and carbon pricing mechanisms.	
	Multilateral climate finance	<u>UN Framework Convention on Climate Change (UNFCCC) financial mechanism funds</u> • Adaptation fund: USD7 million from UN-Habitat to enhance small-scale infrastructure interventions in the coastal regions of the Mekong Delta • Global Environmental Facility Trust Fund (GEF/TF): Total of USD72.3 million to support 18 mitigation projects • Least Developed Countries Fund (LDCF) • Green Climate Fund (GCF) • GEF Small Grants Programme (GEF-SGP) <u>Non-UNFCCC financial mechanism funds</u> • UN: UN-REDD Viet Nam Phase II Programme via UN-REDD Viet Nam Phase II Multi Partner Trust Fund • World Bank: GCF will provide USD86.3 million to spur energy efficiency investments. Other contributors through the World Bank Group are the Transformative Carbon Asset Facility (TCAF), Scaling Climate Action by Lowering Emissions (SCALE), Climate Investment Funds (CIFs), Forest Investment Program (FIP), Forest Carbon Partnership Facility (FCPF) and Partnership for Market Implementation (PMI). • Asian Development Bank: GCF, Urban Climate Change Resilience Trust Fund, and Clean Technology Fund (CTF) of Climate Investment Fund • NDC partnership funds: Global Climate Partnership Fund, Low Carbon Transition in the EE sector, GCF, Capacity Building Initiative for Transparency (CBIT) Trust Fund, CTF and others	
	Bilateral climate finance	• US (USAID): USD2.5 million Innovation Challenge Fund to support innovative energy solutions, Renewable Energy Data Explorer tool • EU: Global Climate Change Alliance Plus (GCCA+) • UK: International Climate Fund (UK-ICF) • JP: Actions for Cool Earth 2.0 (ACE 2.0), Japan's Fast Start Finance (J-FSF)	

Source: Vietnam NDC; UN; World Bank; USAID; GCCA+

Appendix 6. Data Adequacy for Surveillance Purposes: a Preliminary Assessment

Surveillance Areas	Data Availability[(i)]	Reporting Frequency/ Timeliness[(ii)]	Data Quality[(iii)]	Consistency[(iv)]	Others, if Any[(v)]
National Accounts and Inflation	Yearly GDP data is available for both expenditure and production approaches. Quarterly GDP data by expenditure, however, is unavailable. Headline CPI and core inflation data has been released since 2015 using the geometric means method. Current CPI data has been rebased to 2019 (previous base year: 2014) with a new CPI basket weight system based on 2019 consumption. The General Statistics Office (GSO) adjusts basket weights and base year every 5 years.	Estimated GDP data is released within the final week of each quarter; while revised data is usually released by the end of the following quarter.	High-frequency data, such as industrial production and retail sales indices, is not seasonally adjusted and is sometimes in nominal terms only. Underlying index of core inflation is unavailable.	Historical GDP data for 2017-2019 using the new base of 2010 is unavailable, making comparison across time difficult. Reevaluated GDP by expenditure is not publicly available.	-
Balance of Payments and External Position	-	Quarterly balance of payments data is released on the SBV website with a time lag of one to two quarters.	Persistent net errors and omissions make the analysis and interpretation of the data difficult.	-	-
State Budget and Government/ External Debt	Quarterly state budget data is available. Data on the debt of state-owned-enterprises (SOEs) is published on the VMOF website.	The latest Debt Bulletin (in Vietnamese) was released on September 29, 2023. The previous bulletin was released on March 21, 2023.	Certain government borrowings are excluded from the budget data. Public debt covers central government debt, local government debt and central government guaranteed debt only. SOE debt is excluded from the public debt statistics.	-	The newly revised State Budget Law better aligns the reporting of budget data with international standards, effective January 2017.
Money Supply and Credit Growth	Domestic credit data by currency denomination, i.e. LCY and FCY, has yet to be made available.	Monthly data is released on the SBV website with a time lag of two to four months.	-	-	-
Financial Sector Soundness Indicators	-	Monthly data is released on the SBV website with a time lag of two to six months.	-	The implementation of a new loan classification, in accordance with SBV Circular 02 dated 2013, has enhanced the consistency of NPL data since mid-2016.	Officially reported NPL data may not capture the full picture of NPLs in the banking sector. Data on NPL acquisition and disposition by the Vietnam Asset Management Corporation should be included in an assessment on credit quality.
SOE Statistics	SOE statistics, including financial performance, divestment and equitization progress, have yet to be made available on a frequent basis.	-	-	-	-

Notes:
(i) Data availability refers to whether official data is available for public access by any means.
(ii) Reporting frequency refers to the time interval with which available data is published. Timeliness refers to how up to date the published data is srelative to the publication date.
(iii) Data quality refers to the accuracy and reliability of the available data given the data methodologies.
(iv) Consistency refers to both internal consistency within the data series itself and its horizontal consistency with other data series of either the same or different categories.
(v) Other criteria might also apply, if relevant. Examples include but are not limited to potential areas of improvement for data adequacy.

Source: AMRO staff compilation. This preliminary assessment will form the “Supplementary Data Adequacy Assessment" in the EPRD Matrix.

Annexes: Selected Issues

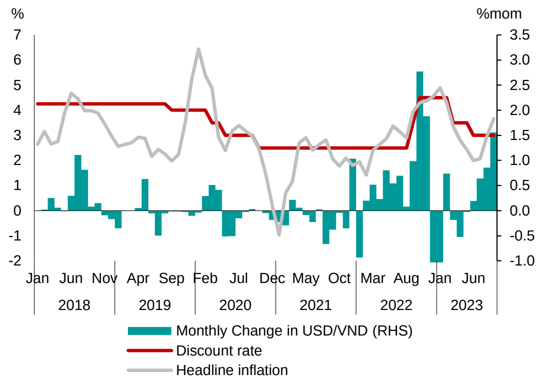
1. Vietnam's Monetary Policy Framework and Operation[48]

1. **The State Bank of Vietnam (SBV) continues to employ direct monetary policy instruments to achieve its policy objectives.** The central bank consistently applies direct controls over credit growth and multiple operating interest rates simultaneously. In 2023, amid slower economic growth with subdued inflation, the SBV raised its indicative credit growth, assigning credit growth quota to individual banks, and reduced operating interest rates. Recently, in the course of strong U.S. dollar appreciation, the SBV has also withdrawn liquidity through open market operations (OMOs) to stabilize the Vietnamese dong. Vietnam's monetary policy is different from many other ASEAN+3 economies, which have adopted an inflation targeting framework with a single short-term interest rate as their central bank's operational target. Thus, this selected issue delves deep into the SBV's monetary operations and policy instruments.

Monetary Policy Framework

2. **The State Bank Law identifies ensuring price stability as the primary monetary policy mandate[49], but in practice, monetary policy is also used to serve other policy objectives.** According to the Law on the State Bank of Vietnam 2016 (Article 3), monetary policy aims to maintain stability of the currency value (inflation rate), and the SBV is mandated to use tools and measures to achieve this objective. However, it has been observed that monetary policy could be employed to achieve macroeconomic growth target and exchange rate stability.. For instance, following the U.S. Federal Reserve's unexpectedly aggressive rate hike in July 2022, the dong depreciated significantly against the U.S. dollar. Despite headline inflation remaining within the 4 percent annual ceiling with mild demand-side pressures, the SBV tightened monetary policy drastically by increasing operating interest rates and absorbing liquidity from the financial system through OMOs to contain the currency depreciation (Figure A1.1).

Figure A1.1. Monetary Policy Direction, Inflation and Exchange Rate Movement



Source: SBV; Vietcombank; CEIC; AMRO staff calculations

3. **The current monetary policy framework is not aligned with the key principles of an inflation targeting regime.** In an inflation targeting regime, a targeted inflation rate or range is determined as the monetary policy goal to be achieved over the mid-term horizon. This target should not change frequently, as it serves to anchor public inflation expectations over the medium term. In contrast, the Vietnamese government and the SBV, with the approval of the National Assembly, announce the annual inflation rate target for the following year at the end of each year. Vietnam's inflation target essentially functions as a de facto

[48] Prepared by Wanwisa May Vorranikulkij, Senior Economist, with input from Thanh Thuy Giang Dao, Associate.
[49] In addition to ensuring price stability, the SBV is also mandated to stabilize the currency value; ensure the safety of banking operations and the credit institutions system; ensure the safety and efficiency of the national payment system; contributing to promoting socio-economic development according to socialist orientation.

operational ceiling that the government and the SBV aim to maintain. This threshold undergoes annual adjustments based on the government's macroeconomic forecast.

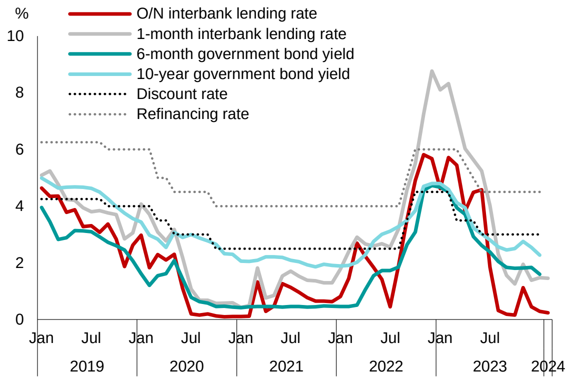
Operational Targets

4. **The SBV continues to deploy direct monetary instruments to control credit quantity and prices.** It has several operational targets, comprising a set of operating interest rates, the credit growth target, and the exchange rate trading band.

(i) Interest rate instruments

5. **There is no single benchmark interest rate, but rather controls over multiple interest rates.** Vietnam does not have a single benchmark interest rate, known as the policy rate or base interest rate, applied by the central bank in transactions with financial institutions, such as repurchase (RP) agreements. When the SBV initiated interest rate liberalization in 2000, it initially introduced a primary interest rate (PIR)[50] to guide VND lending rates offered by commercial banks (Nguyen, 2003). To this day, the PIR remains one of policy instruments, but it is no longer used to signal policy direction. Instead, in response to economic and inflation developments, the SBV controls the movement of operating interest rates that commercial banks use to transact with their clients, including short-term deposit rate caps and lending rate caps for priority sectors (Table A1.1), while allowing other deposit and lending rates to fluctuate through market mechanisms. Furthermore, the SBV adjusts the discount rate and refinancing rate, which serve as reference rates in its lending facilities. These two rates are solely used to signal monetary policy direction but are not employed in OMOs. Consequently, Private commercial banks use deposit rates of state-owned commercial banks as the base rate in calculating their lending and deposit rates. There is also a limited connection between such operating rates and money market rates or bond yields. (Figure A1.2)

Figure A1.2. SBV Operating Interest Rates and Market Interest Rates



Source: SBV; Hanoi Stock Exchange; Haver Analytics; AMRO staff calculations

6. **Based on anecdotal evidence and discussions with commercial banks, the interest rate policy could be transmitted to bank lending and deposit rates through the operations of state-owned commercial banks (SOCBs).** Although the government has gradually allowed SOCBs to operate independently, these banks still dominate the banking sector and support the implementation of the government's policies. SOCBs always adjust their deposit rates immediately following the SBV's announcement of operating rate changes,

[50] The Law on the State Bank of Vietnam gives the SBV the mandate to announce the PIR and other interest rates for the purpose of conducting national monetary policy and combatting usury. The SBV issued Circular 16/2008/TT-NHNN on May 16, 2008, which specified that it would publicly declare the PIR every month. Credit institutions were granted the autonomy to determine their lending rates, provided that they did not exceed 150 percent of the PIR. However, on April 14, 2010, the SBV issued Circular 12/2010/TT-NHNN, which repealed Circular 16 and allowed credit institutions to freely negotiate lending interest rates with borrowers without adhering to the 150 percent margin. The last official announcement of the PIR was on November 29, 2010, which declared a base interest rate of 9 percent per annum effective from December 1, 2010. Although the SBV ceased to declare the PIR at the end of 2010, the 9 percent rate has continued to be widely referenced in laws and contracts, serving as the benchmark rate for resolving civil disputes in court. It can still be considered valid to this day, as stipulated by the State Bank law.

even when the central bank does not conduct OMOs to adjust liquidity in the financial system and influence short-term market rates. Since a single benchmark interest rate is absent, and the SBV's monetary operations do not aim to align money market rates with any of its operating rates, private commercial banks consistently benchmark their deposit rates against SOCBs' average 12-month deposit rates. Despite this benchmarking, private commercial banks offer varying deposit rates as the levels are also subject to liquidity at the individual bank. For private banks, their lending rates reflect their financial and operational costs, market competition and customers' risk premium.

Table A1.1. Adjustment of Operating Interest Rates in 2023 to Tackle Growth Slowdown

Instrument	Prior to March 15	From March 15	From April 3	From May 25	From June 19
<1 month deposit rate cap	1.00%	1.00%	0.50% (-50 bps)	0.50%	0.50%
1-6 month deposit rate cap at commercial banks	6.00%	6.00%	5.50% (-50 bps)	5.00%	4.75% (-25 bps)
1-6 month deposit rate cap at microfinance institutions	6.50%	6.50%	6.00% (-50 bps)	5.50% (-50 bps)	5.25% (-25 bps)
Lending rate cap for loans made to priority sectors[1/] by commercial banks	5.50%	5.00% (-50bps)	4.50% (-50 bps)	4.50%	4.00% (-50bps)
Lending rate cap for loans made to priority sectors by microfinance institutions	6.50%	6.00% (-50bps)	5.50%	5.50%	5.00% (-50 bps)
Refinancing rate	6.00%	6.00%	5.50% (-50 bps)	5.00% (-50bps)	4.50% (-50 bps)
Discount rate	4.50%	3.50% (-100bps)	3.50%	3.50%	3.00% (-50 bps)
Overnight lending rate in SBV clearing system	7.00%	6.00% (-100bps)	6.00%	5.50% (-50 bps)	5.00% (-50 bps)

Source: SBV; Maybank; AMRO staff compilation
Note: 1/ Priority sectors include agricultural and rural development, exports, industry support, the high-tech industry, and SMEs.

(ii) Direct control over credit supply

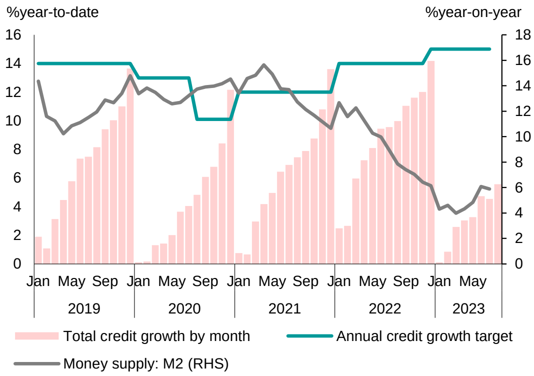
7. **Control over the credit growth is one of the SBV's primary monetary tools.** The SBV decides the *'indicative credit growth'* for the entire banking system and allocates credit growth targets to individual banks at the beginning of the year, with revisions as needed throughout the year (Figure A1.3). Credit institutions, including banks, are not permitted to extend credit beyond their individually assigned quotas, which are based on their respective financial soundness, demand, and credit expansion capacity. In addition to regulating the total credit amount, the SBV also encourages credit institutions to prioritize productive sectors such as trade and manufacturing. Prudential regulations, including higher risk weights, are applied to specific sectors to ensure that credit is not directed toward risky areas.

(iii) Exchange rate target

8. **Vietnam's exchange rate regime has shifted gradually toward a more market-determined and flexible system (IMF, 1996; AMRO, 2018).** The SBV announces the central reference USD/VND rate and its trading band daily. It calculates the reference rate based on the weighted average of the interbank exchange rate as well as the movement of the Vietnamese dong relative to eight foreign currencies of countries that have important trade, investment and borrowing-lending links with Vietnam. According to the SBV, the reference rate of VND/USD is determined based on the developments of major trading partners' currencies against the US dollar, the movement of the Vietnamese dong in the interbank market, Vietnam's macroeconomic and financial conditions, as well as the SBV's monetary

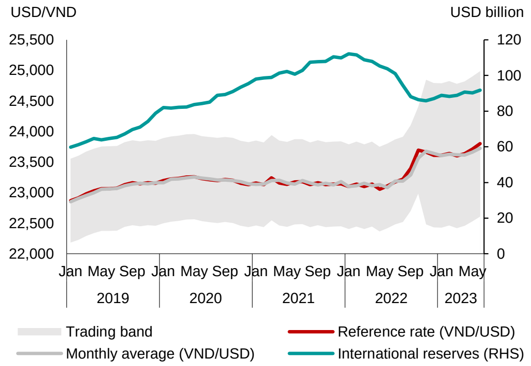
policy goal at that period. In July 2022, when the U.S. Federal Reserve aggressively tightened monetary policy, the Vietnamese dong came under sharp depreciation pressure which necessitated the SBV's intervention in the FX market in tandem with moves to mop up liquidity from the financial system to stabilize the foreign exchange market. Following this incident, the central bank decided to expand the spot exchange rate band from ±3 percent of the central exchange rate to ±5 percent in October 2022 to allow more exchange rate volatility (Figure A1.4).

Figure A1.3. Credit Growth Target and Actual Outturns



Source: SBV; CEIC; AMRO staff calculations

Figure A1.4. FX Trading Band

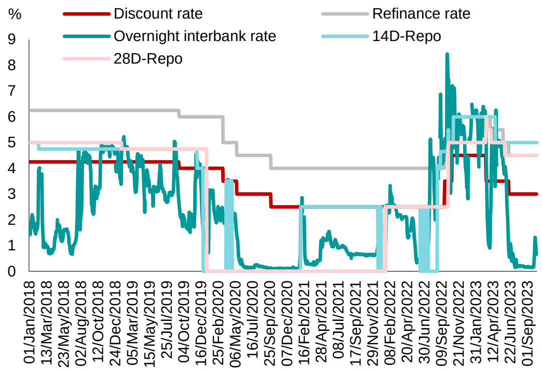


Source: SBV; Vietcombank; CEIC; AMRO staff calculations

Liquidity Management Tools

9. **The SBV continues to employ direct monetary policy instruments primarily, while the linkage between its OMOs and money market rates remain weak (Figure A1.5).** The OMOs are conducted through securities transactions and the issuance and repurchase of State Bank bills (Table A1.2). *Securities transactions* are designed to manage short-term liquidity in the banking system through outright transactions and RP transactions. RP transactions are a primary OMO instrument with three tenors: seven days, 14 days and 28 days. The SBV conducts RP transactions to ensure that liquidity in the financial system is consistent with monetary policy directions, using the overnight interbank lending rate as an indicator of liquidity conditions. The SBV intends to implement OMO to manage the liquidity condition. However, amid an absence of the policy base rate and an interest rate corridor, the SBV does not consider it necessary to align OMO interest rate with the overnight interbank rate when liquidity conditions in the banking system is stable. This partly explains the divergence of the overnight interbank lending rate and the OMO rates, especially in recent months (Figure A1.4). In addition, there is no interest rate

Figure A1.5. Monetary Policy Direction and Liquidity Conditions



Source: SBV; CEIC; Bloomberg

corridor to guide the movement of short-term interest rates alongside the OMO rate, which is preliminarily set by the SBV. *State Bank bills* are used for longer-term liquidity management.[51]

10. **Commercial banks can seek lending support from both the SBV and SOCBs.** In their day-to-day operations, these banks may face liquidity shortages due to unexpected withdrawals and will typically borrow either from the interbank market or through OMOs. When interbank interest rates are lower than OMO rates, commercial banks tend to prefer obtaining financing from the interbank market, where the primary lenders are SOCBs. Although the SBV offers discount and refinancing loans, these facilities are not widely used due to administrative procedures. Accessing such loans requires the requesting bank to provide more extensive information to the SBV compared with practices followed in end-of-day standing lending facilities offered by other central banks. Additionally, the AMRO mission has found in discussions with market participants that if a commercial bank encounters financial difficulties, the SOCBs would be instructed to provide special financial assistance to the troubled institution.

Table A1.2. Summary of SBV Liquidity Management Tools

Tools	Definition
Short-term liquidity management (OMO instruments)	
RP transaction	Repo and reverse repo are OMO instruments for short-term liquidity withdrawal and injection. There are three major tenors: seven days, 14 days and 28 days. The seven-day maturity is mainly used for daily liquidity management, while the longer tenors are pprimarily for liquidity support or withdrawal in extraordinary circumstances.
Outright transaction	The State Bank buys or sells eligible securities outright on the market to control short-term liquidity more permanently than RP transactions.
Central bank bills	The SBV issues bills to manage liquidity in the system, sterilize the purchase of foreign currency for reserve accumulation, or stabilize the exchange rate when it is under pressure. Maturities range from 14 to 91 days.
Longer-term liquidity management	
Reserve requirement ratio (RRR)	Banks and non-bank credit institutions are required to maintain a proportion of deposits with the SBV relative to the total value of deposits collected by them. The RRR varies based on factors such as the deposit currency (the dong or a foreign currency), deposit maturity and type of credit institution. The SBV does not frequently adjust the RRR in response to economic developments. The SBV pays a required reserve interest rate to compensate commercial banks for the required reserve and the excess reserve deposited with the SBV. The interest rates are 0 percent for required foreign currency reserves and excess foreign reserves, 0.5 percent for required dong reserves, and 0 percent for the excess reserve.
Discount loan	Commercial banks may request a discount loan from the SBV if they are unable to access liquidity support through the OMOs or in the interbank market to meet unforeseen demand. To obtain a discount loan, a commercial bank must provide collateral, such as treasury bills, treasury bonds, State Bank bills and other types of valuable papers stipulated by the SBV Governor during each specific period. The interest rate on a discount loan is called the discount rate (Table 1.1). It is now at 3.0 percent.
Refinancing loan	Commercial banks have the option to request a refinancing loan from the SBV when they cannot get liquidity support through the OMOs, the interbank market, or a discount loan due to insufficient assets that can be used as collateral. In such a scenario, a bank can use its loan portfolio categorized as Group 1—Standard or Pass—as collateral. The bank is allowed to secure a refinancing loan of up to 60 percent of the value of the loan portfolio offered as collateral. The interest rate on a refinancing loan is known as the refinancing rate (Table 1.1). It is higher than the discount rate, reflecting the weaker financial position of the borrowing bank. Currently, the refinancing rate is set at 4.5 percent.

[51] The SBV issues State Bank bills with various maturities—namely, 7 days, 14 days, 28 days, 3 months, and 6 months—to manage liquidity in the financial system, aiming to achieve monetary policy goals in response to corresponding economic circumstances. However, market participants and anecdotal evidence indicate that the issuance and early redemption of these bills are occasionally utilized for sterilization or to stabilize the exchange rate when it comes under pressure.

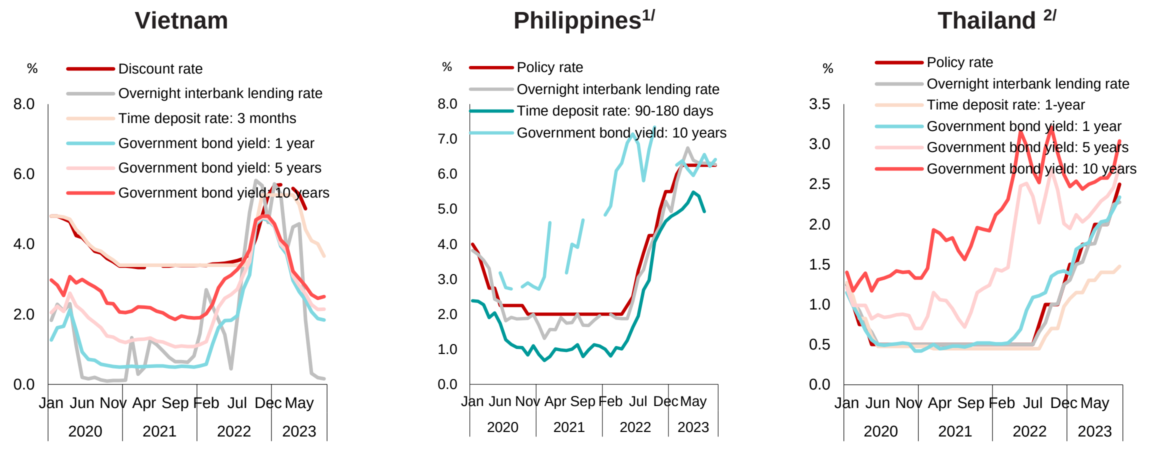
Tools	Definition
Liquidity support by SOCBs	When a joint-stock commercial bank (private commercial bank) encounters financial difficulties, SOCBs would step in to provide special financial assistance to the troubled bank.

Source: SBV Circular No. 42/2015/TT-NHNN and Circular No. 09/2021/TT-NHNN; AMRO staff compilation

Policy Considerations

11. **The rapid development of the Vietnamese economy necessitates a transition toward a more market-based monetary policy regime.** On one hand, Vietnam's economic activities have gradually shifted from a centrally planned economy to a market-based one. Capital markets have developed, and demand for new financial instruments is increasing. On the other hand, despite years of interest rate liberalization, the SBV's operational targets still comprise a combination of quantitative-based measures and are a form of interest rate control. Looking ahead, the current regime is likely to become less and less effective in macroeconomic management with the changing economic and financial landscape, and might unintentionally distort market behaviour, posing challenges to market development. This is evident in the increasing fragmentation of Vietnam's financial markets and the slow progress of derivatives markets. In this context, it is worth considering a gradual phaseout of direct monetary instruments and allowing for market-based policy instruments to play a more significant role (Figure A1.6).

Figure A1.6. Interest Rate Movement and Policy Rate in Selected ASEAN Countries



Source: National authorities

Note: 1/ Bangko Sentral ng Pilipinas (BSP) adopted an interest rate corridor (IRC) system in 2016 to strengthen monetary policy transmission to short-term money market interest rates. Since then, the BSP has constantly refined the system to enhance effectiveness, such as by introducing new absorption tools. During 2022-2023, several important adjustments were also made to improve monetary policy transmission and support market development (AMRO 2023 Annual Consultation Report on the Philippines).

2/ The Bank of Thailand's (BOT) monetary policy instruments comprise reserve requirements, OMOs, standing facilities, a securities borrowing facility, and lending facilities if real-time gross settlement, or the BATHNET, is completely offline. The BOT employs an IRC system to maintain the short-term interest rate in line with the BOT's policy rate (one-day RP transactions).

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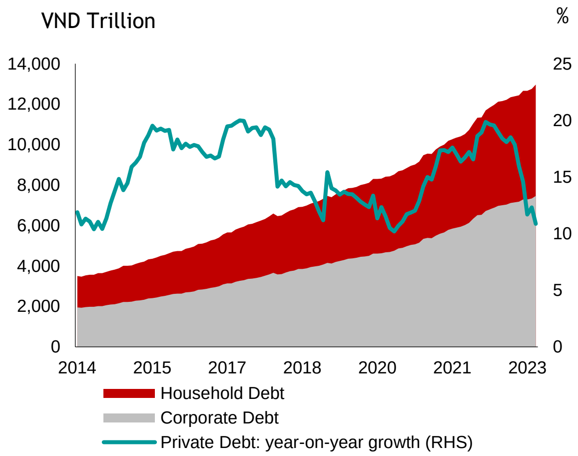
2. Vulnerabilities in Corporate Debt Landscape[52]

1. **Corporate debt in Vietnam has steadily increased over the past few years.** Debt held by companies is estimated to be three to four times what it was a decade ago (Figure 2.1). Compared with GDP, corporate debt has also risen in the same period (Figure 2.2). Vietnam's corporate debt-to-GDP ratio in 2022 is found to be high relative to peers with similar economic development in the ASEAN+3 region (Figure 2.3). The low interest rate environment and increased opportunities in a fast-growing economy could have led to more corporate debt.

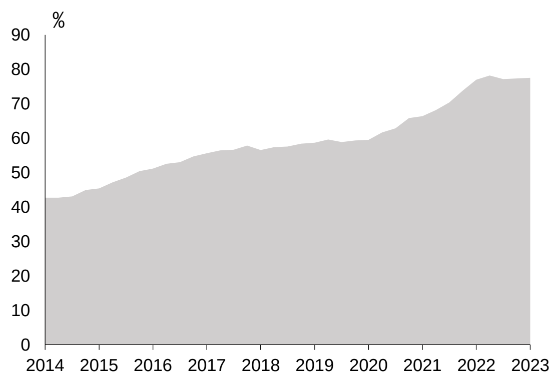
2. **The current selected issue assesses the nature of vulnerabilities in the corporate sector, as higher leverage is often associated with the risk of a financial crisis.** The nature and profile of corporate borrowers are examined using firm-level data from Moody's Orbis database. One caveat about the analysis is that the data quality, particularly of less readily available information about small and medium-sized enterprises (SMEs), would depend on the effectiveness of Moody's data gathering exercise. The Orbis dataset is compiled through local information providers, telephone research, company websites, newswires, private correspondence and other avenues, and the data availability and completeness vary by economy.

Figure 2.1. Outstanding Private Debt, 2014-23



Source: AsianBondsOnline; SBV; Haver Analytics; AMRO staff calculations
Note: Overall private-sector debt comes from both bank lending and bond financing. As the breakdown of corporate and household debt is not publicly available, this note gives an estimate. Out of all banking loans, 55 percent are assumed to be provided to corporations, based on information obtained from the annual reports of the largest banks in Vietnam. All bond financing is assumed to be channeled toward the corporate sector.

Figure 2.2. Corporate Debt-to-GDP Ratio, 2014-23



Source: AsianBondsOnline; SBV; Haver Analytics; AMRO staff calculations
Note: Corporate debt is based on AMRO's estimation, in line with Figure 1.

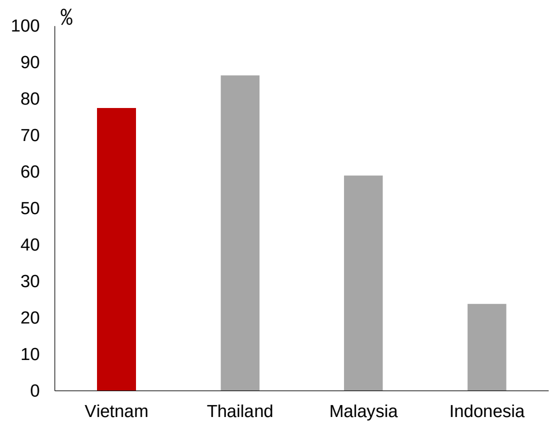
3. **In addition to debt exposure, borrowers' capacity to fulfill their debt obligations is evaluated using a commonly used solvency metric, the interest coverage ratio (ICR)**. An ICR of less than 1.25 means that the company has speculative ratings, analogous to S&P's "CCC" rating and below (Domodaran 2016). This analysis is crucial, given that the COVID-19 pandemic may have lasting scarring effects on corporate-sector balance sheets. Furthermore, Vietnam's high dependence on trade makes the economy susceptible to external challenges, such as weakened demand and adjustments in the monetary policy

[52] Prepared by Wong Siang Leng, Wanwisa (May) Vorranikulkij, and Thanh Thuy Giang Dao.

stance of major economies, as well as supply chain disruptions. Additionally, the country faces domestic downside risks related to the real estate market.

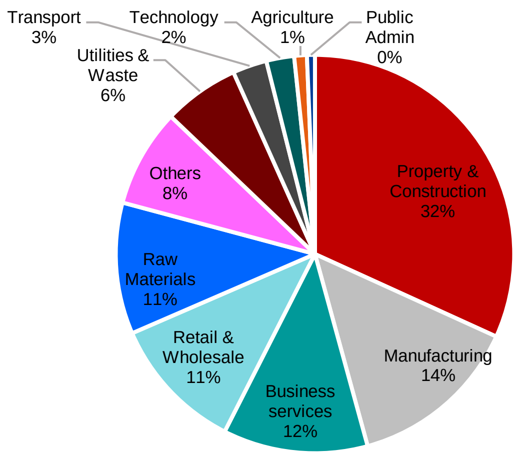
4. **Debt appears to be concentrated in certain sectors**. One-third of corporate debt is held by companies engaged in real estate development and construction, followed by manufacturing and business services (Figure 2.4). Notably, property-related companies experienced a liquidity crisis during the pandemic (Barnes 2023). Corporate debt could be largely accumulated by the bigger firms, which are categorized as "Listed" or "Unlisted-Other" in the note. While SMEs do receive credit, of about 35 percent of overall corporate debt (Figure 2.5), the share is less than proportionate to the 96 percent by firm count in the economy (OECD 2021). The lack of accounting transparency and inadequate pledging of collateral are commonly cited as reasons for the insufficient financing access.

Figure 2.3. Corporate Debt-to-GDP Ratio by Economy, 2022



Sources: AsianBondsOnline; SBV; Haver Analytics; and AMRO staff calculations.
Note: The corporate debt-to-GDP for Vietnam is an estimation, in line with Figure 1.

Figure 2.4. Corporate Debt by Sector, 2022



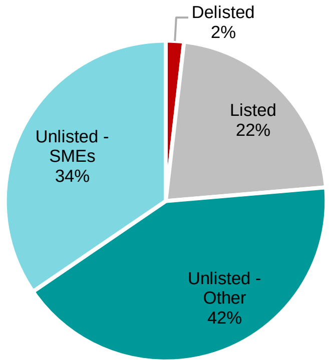
Sources: Orbis of Moody's Analytics; and AMRO staff calculations.

5. **A single distressed listed firm could be of concern.** While less than 10 percent of listed firms are expected to be vulnerable in terms of their cash buffers (Figure 2.6), spillover risks, if any, could be pronounced (Figure 2.7). It might also be worrying that the share of at-risk listed firms appears to have increased in the past year, while the share of unlisted firms has remained quite constant (Figure 2.8). However, a blessing in disguise is that the listed firms' debt mostly resides in sectors that are less risky or assessed to have rather adequate cash buffers in place (Figures 2.9, 2.10).

6. **In comparison, SMEs might be riskier individually but are less likely to pose systemic risk**. Almost 80 percent of SMEs could encounter difficulties in using their profits to service their debts, the highest percentage among firm types (Figure 2.6). When their full cash reserves are considered, assuming no haircuts or currency adjustments, the share of at-risk SMEs decreases significantly, but almost half remain at risk. Smaller companies often contend with technology and skilled labor deficiencies, along with challenges in achieving economies of scale (Yoshino and Taghizadeh-Hesary 2016), leading to lower profitability and ICRs. Additionally, SMEs typically exhibit lower transparency and weaker corporate governance compared to their listed counterparts. That said, among the various types of firms, the potential for spillover risks in the event of a single or a few SME insolvencies is expected to be negligible

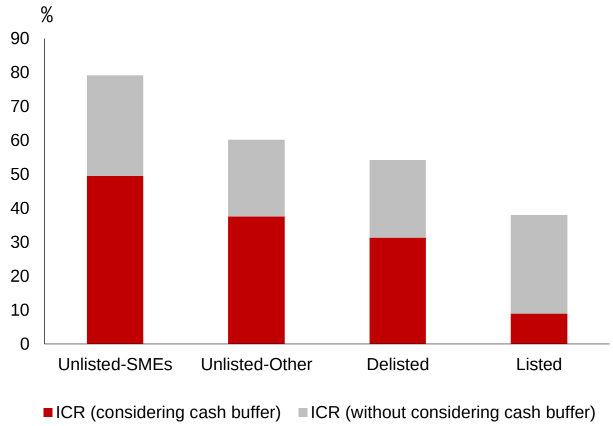
(Figure 2.7), though their collective inability to service debt could affect upstream and downstream counterparts.

Figure 2.5. Corporate Debt by Firm Type, 2022



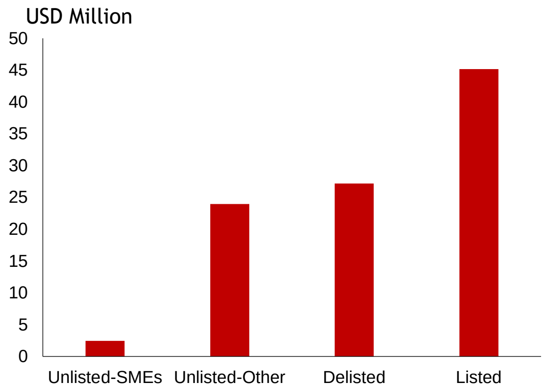
Source: Orbis of Moody's Analytics; SBV; AMRO staff calculations
Note: The estimated share of unlisted SMEs is derived from the share of SME loans announced by the SBV (**SBV 2023a**).

Figure 2.6. Debt at Risk by Firm Type, 2022



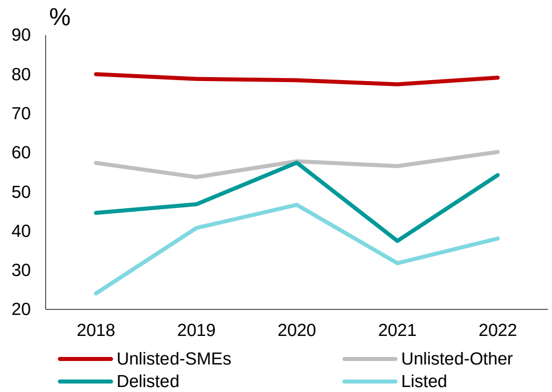
Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

Figure 2.7. Average Debt per Borrower by Firm Type, 2022



Source: Orbis of Moody's Analytics; AMRO staff calculations

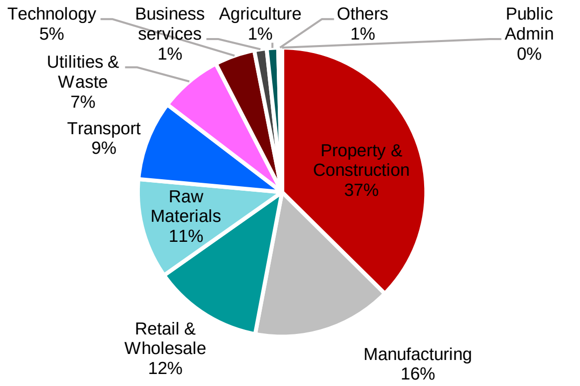
Figure 2.8. Share of Debt at Risk by Firm Type, 2018-22



Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

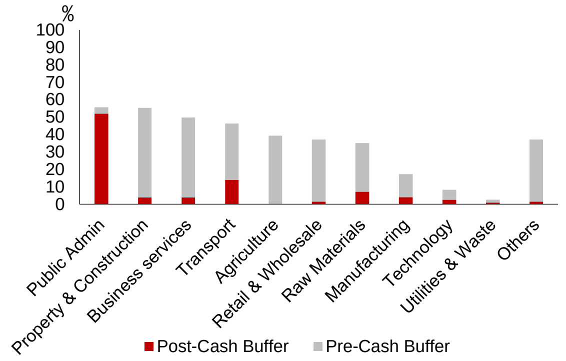
7. **That said, boosting the resilience of unlisted firms as a whole remains a top priority, in particular considering the higher concentration of such firms in riskier segments.** SME debt is heavily concentrated in the property and business sectors, which have lower ICRs and higher risk profiles than their counterparts (Figures 2.11, 2.12). Moreover, while the debt of manufacturing and raw material firms among unlisted entities appears less vulnerable, business service firms, the next major category, face significant risk (Figures 2.13, 2.14). Reducing costs for these firms can assist in bolstering profits, thereby reinforcing their resilience. One way to achieve this could be to lower borrowing costs by simplifying procedures for interest rate support applications and strengthening credit guarantee funds. Such efforts could also lessen the need for physical collateral, which is a challenge to unlisted smaller firms. In addition, state-owned commercial and social policy banks could play a role by maintaining ample capital reserves to facilitate easier financing for unlisted firms.

Figure 2.9. Listed Firm Debt by Sector, 2022



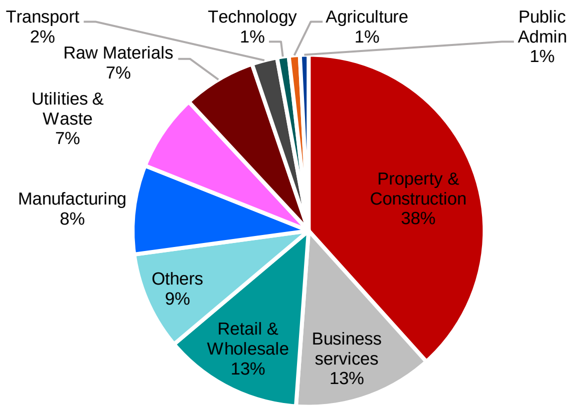
Source: Orbis of Moody's Analytics; AMRO staff calculations

Figure 2.10. Listed Firm Debt at Risk by Sector, 2022



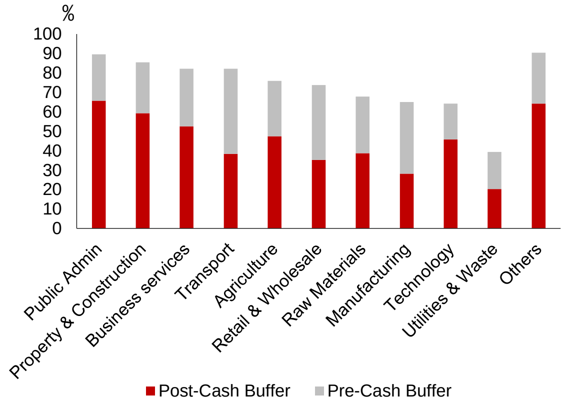
Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

Figure 2.11. SME Debt by Sector, 2022



Source: Orbis of Moody's Analytics; AMRO staff calculations

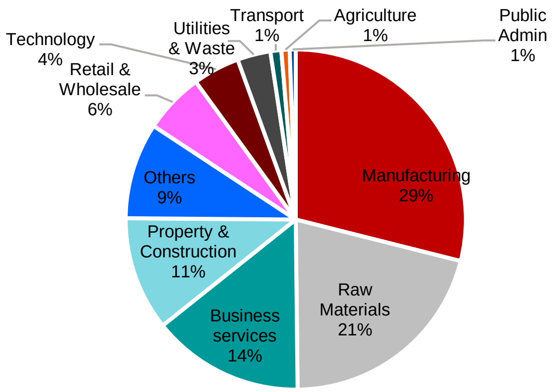
Figure 2.12. SME Debt at Risk by Sector, 2022



Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

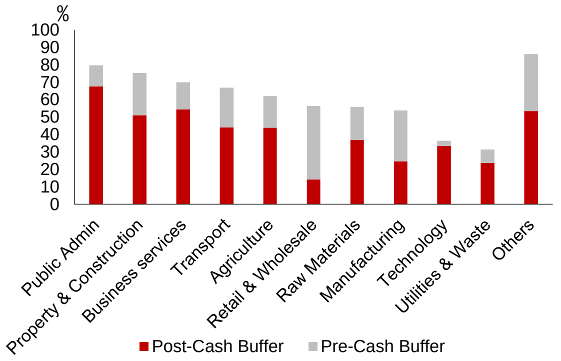
8. **While bank loans remain the primary source of corporate financing, it is essential to recognize the close connection between bond financing and bank lending.** In the past decade, corporate debt in the form of bonds as a share of total corporate debt more than doubled (Figure 2.15). The growth in bond issuances typically outpaced the expansion of bank financing, a trend particularly pronounced during the pandemic (Figure 2.16). The escalation in bond issuances could be attributed in part to a tightening of bank lending standards and stronger demand associated with investors' searching for yield in the low interest rate environment. It is worth recognizing that most of the investors in the bond market are domestic financial institutions, including the banks (AMRO 2022). Besides the direct relationship, there are also indirect ties between bond financing and bank lending. For instance, the bond market's confidence suffered in 2022 due to disorderly market conduct by some property developers (AMRO 2022), which subsequently raised concerns about potential challenges for banks' borrowers to refinance and roll over debts as market liquidity dried up. Borrowers from certain market segments also found it more difficult to obtain financing from banks.

Figure 2.13. Unlisted Other Firm Debt by Sector, 2022



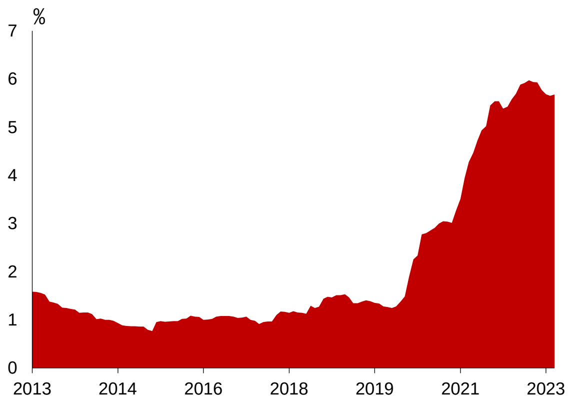
Source: Orbis of Moody's Analytics; AMRO staff calculations

Figure 2.14. Unlisted Other Firm Debt at Risk by Sector, 2022



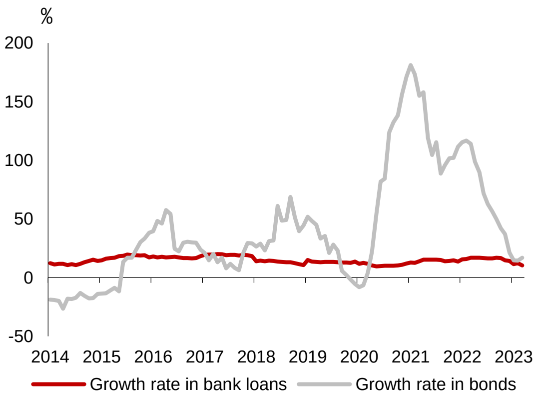
Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

Figure 2.15. Share of Corporate Debt in the Form of Bonds, 2013-23



Source: AsianBondsOnline; SBV; Haver Analytics; AMRO staff calculations
Note: Corporate debt (denominator) is based on AMRO's estimation, in line with Figure 1.

Figure 2.16. Growth in Different Corporate Debt, 2020-23



Source: AsianBondsOnline; SBV; Haver Analytics; AMRO staff calculations
Note: The growth rate of bank loans encompasses loans that banks have provided to households, which may also be used for business purposes.

9. **The SBV has taken measures to moderate leverage and concentration risks associated with corporate debts**. First and foremost, the SBV has stepped up the appraisal and surveillance of loans, including those granted to the corporate sector (SBV 2018), especially since Vietnamese corporate debt continues to rise and remains high compared with its ASEAN+3 peers. Second, the central bank has directed banks to reduce credit in risky sectors (SBV 2023b), which will help the banking sector to diversify its lending and reduce concentration risks. This is particularly important given the substantial share of loans extended to property developers. Third, the government has issued Decree 65/2022/ND-CP in an effort to develop a more transparent bond market (Vietnam Bond Market 2022). Greater transparency in corporate balance sheets, aided by credit rating agencies, would enable banks and bond market investors to make more informed decisions.

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3. Financial Support for SMEs: Credit Guarantee Schemes and SME Development Fund[53]

1. **Despite the considerable size of the SME sector in Vietnam's economy, access to finance is a major hurdle for many SMEs.** According to a 2022 government report, the country has about 800,000 SMEs, which made up 98 percent of all registered businesses.[54] These companies employed around 70 percent of the workforce and accounted for about half of the country's GDP. However, many SMEs face difficulties in securing funding. Roughly 30 percent have access to bank credit, and about a quarter consider financial access the main obstacle in their business operations.[55]

2. **Credit guarantee schemes (CGSs) and the SME Development Fund (SMEDF) are two main avenues of financial support available to SMEs.** Recognizing the challenges faced by SMEs in obtaining credit, the government started issuing legal frameworks for the creation of CGSs in 2001 and the SMEDF in 2013. Alongside commercial banks' own loan products that are tailored to SMEs, the CGSs and the SMEDF are two main channels through which SMEs can get financing in Vietnam. The current selected issue discusses these two channels.

Credit Guarantee Schemes

3. **There are two main types of CGSs, one of which is in the form of local credit guarantee funds (CGFs).** These funds were established by provincial People's Committees, guided by a series of decrees dating back to 2001. The charter capital mostly came from provincial budgets – with the rest contributed by local financial institutions – with the goal of providing credit guarantee to businesses that faced difficulties in accessing financial resources. CGFs function as non-profit financial organizations and are managed by provincial People's Committees. At present, the combined charter capital of all local CGFs is around VND1.4 trillion, the lion's share of which is publicly owned.[56]

4. **The other type of CGS is operated through Vietnam Development Bank (VDB).** Recognizing the need to further enhance SMEs' financial access, the government issued a number of regulations during 2009-2011, according to which VDB – wholly owned by the government and mandated to fund business activities in line with Vietnam's development – was assigned to serve as the country's other major provider of credit guarantee. As the institution was already in the lending business, particularly for enterprises under government support, VDB was deemed a suitable addition to the CGS landscape. At present, the bank has charter capital of VND30 trillion.

5. **According to government regulations on credit guarantee, the borrower's own equity needs to account for at least 15-20 percent of the cost of the business project for which the loan is given.** In the case of local CGFs, the regulations are as follows: the borrower's own equity has to be at least 20 percent of the project cost; the total guarantee extended to a single enterprise and its related parties cannot exceed 20 percent of the local CGF's charter capital; and the total guarantee extended by a local CGF cannot exceed three times its charter capital. As for credit guarantee provided by VDB, the regulations are as

[53] Prepared by Jade Vichyanond, Economist.
[54] Ministry of Information and Communication. Viet Nam News (2023). *SMEs Development Fund Plans Further Reduced Interest Rates.* https://vietnamnews.vn/economy/1582453/smes-development-fund-plans-further-reduced-interest-rates.html
[55] OECD (2021). *SME and Entrepreneurship Policy in Viet Nam.* OECD Studies on SMEs and Entrepreneurship.
[56] Based on AMRO's discussions with several institutions. This amount has remained roughly stable since 2017, when there were 27 local CGFs, which had combined charter capital of VND1.5 trillion, of which 90 percent was from provincial budgets and the remainder was from contributions of the private sector, primarily local credit institutions. Le and Anh (2019). *Challenges in Implementing the Credit Guarantee Scheme for Small and Medium-Sized Enterprises: The Case of Viet Nam.* ADBI Working Paper Series.

follows: the borrower's equity has to be at least 15 percent of the project cost; the total guarantee extended to a single enterprise cannot exceed 5 percent of VDB's charter capital; and the total guarantee extended by VDB cannot exceed five times its charter capital.

6. **While local CGFs require collateral to grant credit guarantee, VDB has no explicit collateral requirement.** Local CGFs stipulate a collateral requirement of 15 percent of the guaranteed amount, whereas VDB does not have an explicit collateral requirement. For both types of CGSs, the amount of guarantee depends on the specific needs of the given loan and can cover up to the entire value of the loan. As for guarantee fees, local CGFs charge 0.5-1 percent of the guaranteed amount per annum, while the fee at VDB is 0.5 percent.

7. **The total amount of guarantee provided by both types of CGSs since their inception has been relatively limited.** In the period of 2002-2016, the cumulative amount of credit guarantee granted by local CGFs was only USD179 million. As the guarantee was provided for US$224 million of loans, the average guarantee was around 80 percent of the loan value.[57] Meanwhile, VDB only issued credit guarantee during 2009-2011, with a total guaranteed amount of USD571 million.[58] From 2017 onwards, VDB has officially ended its credit guarantee activities, as directed by the government.[59]

8. **One of the main challenges in the development of the CGS infrastructure in Vietnam is human resource capacity, which often leads to unwillingness to extend credit guarantee.** As local CGFs are managed by provincial People's Committees, loan appraisal is undertaken by staff members of the committees who for the most part lack such experience and hence are often unwilling to provide credit guarantee. The hesitation is largely due to fear of criminal prosecution (i.e. in case of loan default and subsequent guarantee activation), which has intensified over the past few years in light of the anti-corruption campaign within the government.

9. **Another challenge lies in the complicated procedures for guarantee applications and guarantee activation.** First, a substantial amount of paperwork is required in applying for credit guarantee, which – compounded by the lack of transparent financial accounting on the part of SMEs – makes the application process cumbersome. Moreover, for local CGFs, guarantee activation involves the participation of numerous agencies (i.e. the provincial People's Committee, the local Department of Finance, among others), which sometimes complicates the process of collateral disposal, thereby discouraging commercial banks from accepting credit guarantee.[60]

10. **Collateral requirement has also been a key factor in limiting the growth of local CGFs.** For example, the Ho Chi Minh City CGF – one of the most active CGFs in Vietnam – and the Bac Ninh CGF were growing healthily up until 2013, when a new policy on collateral requirement was announced.[61] (Prior to this, there was no explicit collateral requirement.) After the policy came into effect in 2014, the value of newly guaranteed loans decreased significantly.

11. **Moreover, the limited size of existing CGFs may hamper their ability to significantly enhance the overall SME sector's access to funding.** Based on regulations

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[57] Le and Anh. 2019. *Challenges in Implementing the Credit Guarantee Scheme for Small and Medium-Sized Enterprises: The Case of Viet Nam.* ADBI Working Paper Series.
[58] Information obtained from VDB upon AMRO's data request, using the average exchange rate of 18,729 VND/USD during 2009-2011.
[59] The direction was outlined in the government office's document No. 8273/VPCP-KTTH, which gave no rationale for ceasing VDB's credit guarantee activities.
[60] Le and Anh. 2019. *Challenges in Implementing the Credit Guarantee Scheme for Small and Medium-Sized Enterprises: The Case of Viet Nam.* ADBI Working Paper Series.
[61] The amended Decree 115/2004/QD-TTg, in accordance with Decision 58/2013/QD-TTg.

governing leverage ratios, local CGFs have the potential to provide up to only VND4.2 trillion of credit guarantee, a low level considering the role that SMEs have in the economy and their financing needs.[62]

12. **Looking ahead, greater participation of the private sector, particularly commercial banks, in local CGFs may lead to greater provision of credit guarantee to SMEs.** To the extent that bank ownership increases, banks will be incentivized to become more involved in the administration of credit guarantee, which will likely enhance local CGFs' operational performance – due to greater experience in loan appraisal and management, as experience from various countries has shown – and result in higher approval rates for credit guarantee.[63]

SME Development Fund

13. **The SMEDF is a non-profit fund established in 2013 by the government to support the SME sector, primarily through lending at preferential rates.**[64] The development fund, backed by charter capital of VND2 trillion from the state budget and managed by the Ministry of Planning and Investment, started operations in 2016, channeling funds to SMEs through five commercial banks. In 2019, a decision was made for the fund to start lending directly to SMEs.

14. **Loans are provided at preferential rates and cannot exceed 80 percent of the cost of the business project.** At present, the rates are 1.2 percent for short-term loans and 4.4 percent for medium and long-term loans.[65] According to the regulations, the loan value cannot exceed 80 percent of the project cost, with the enterprise's own equity having to constitute at least 20 percent. The maximum maturity of SMEDF loans is seven years, and the maximum grace period for repayment is two years.

15. **As is the case with CGFs, the SMEDF's growth has been limited, especially considering the demand for SME financing in Vietnam.** As of August 2023, the SMEDF has disbursed less than VND600 billion since its inception.[66] In terms of reach, fewer than 40 SMEs have been beneficiaries of the fund's lending program.

16. **Strict loan criteria are a major hindrance for usage of the SMEDF.**[67] Since 2019, the scope of SMEDF support has been narrowed to only SMEs that are considered innovative startups or part of business clusters or value chains, rendering vast numbers of SMEs such as co-operatives and household businesses ineligible for SMEDF loans. Moreover, SMEDF funding is available only for asset-backed projects, not for other purposes such as working capital.

17. **Recalibration of lending criteria may be needed with a view to increasing the usage of SMEDF loans.** The government's periodic adjustment of preferential interest rates, such as the recent rate reduction in October 2023 in response to the subdued economic environment, is commendable. Going forward, recalibration of loan criteria, such as widening the scope of business activities and sectors eligible for funding, may help increase awareness of SMEDF among SMEs and lead to greater utilization of its lending facility.

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[62] VDB's maximum credit guarantee is VND150 trillion, but its credit guarantee function has been discontinued (see paragraph 7).
[63] Gozzi and Schmukler. 2016. *Public Credit Guarantees and Access to Finance.* Warwick Economics Research Paper Series.
[64] The SMEDF's remit also includes capacity building through training and consultancy.
[65] These rates are adjusted occasionally by the government depending on macroeconomic conditions.
[66] Viet Nam News. 2023. *SMEs Development Fund Plans Further Reduced Interest Rates.* https://vietnamnews.vn/economy/1582453/smes-development-fund-plans-further-reduced-interest-rates.html
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AMRO
ASEAN +3 MACROECONOMIC RESEARCH OFFICE
Address: 10 Shenton Way, #15-08
MAS Building, Singapore 079117
Website: www.amro-asia.org
Tel: +65 6323 9844
Email: enquiry@amro-asia.org

LinkedIn | **Twitter** | **Facebook**