VEPR

VIET NAM QUARTERLY MACROECONOMIC REPORT

Quarter 4 - 2018

Supported by:

Konrad Adenauer Stiftung

SUMMARY

- The year of 2018 witnessed the uneven and unsteady recovery of the world economy. Many international organizations have continuously lowered their forecasts. The latest estimates show that the world economic growth rate in 2018 is about 3.7%. However, there are differences between different country groups and even among countries in the same groups.
- Concerns about China's economy are growing as its trade and investment growth is expected to continue to decline due to trade tension with the US in the coming time. China's PMI dropped below 50. The PBoC has begun to implement monetary easing to stimulate the domestic economy. Although there is still room for policy, everything is getting worse for China.
- Besides the unsteady economic growth and the US-China trade war, the world economy in 2018 also witnessed another remarkable event: the process of "normalizing" monetary policy that is happening in the US and Europe after quantitative easing programs in the past. Meanwhile, it is likely that the Bank of Japan will continue the program of quantitative easing due to low inflation.
- Viet Nam's economy in 2018 saw the highest growth in 10 years, at 7.08% (yoy). Growth came from the robust recovery of the agriculture, forestry, fisheries and service sectors, along with the breakthrough of the manufacturing industry. The FDI sector continued to be the main contributor to growth through exports. This sector in 2018 saw an export surplus of 32.81 billion USD (equal to nearly 14% of GDP).
- Regarding business activities, while the number of newly established enterprises and new jobs did not differ much from that of 2017, the number of temporarily ceased enterprises in 2018 was unusually high, which yield questions whether that is because of the economic structural shift or the fundamental risk of the economy.
- Inflation in Q4/2018 showed signs of decline thanks to the sudden drop in energy prices. Average inflation (3.54%) reached the National Assembly's target. In the context of erratic global commodity prices, along with the increase of the environmental protection tax on petroleum to maximum level since 01/01/2019, the SBV still needs to evaluate inflation risks in the coming time to have appropriate measures.
- The US-China trade war is creating a mixed impact on Vietnam's economy. If the exchange rate policy is implemented appropriately, Viet Nam can benefit from this war. In order to absorb the production supply chain that shifts from China, Viet Nam needs to improve the institutional and business environments and its labor quality. There is also another challenge for Viet Nam as the country's infrastructure is not yet ready to receive waves of the production shift and there are no economies of scale like China and India.

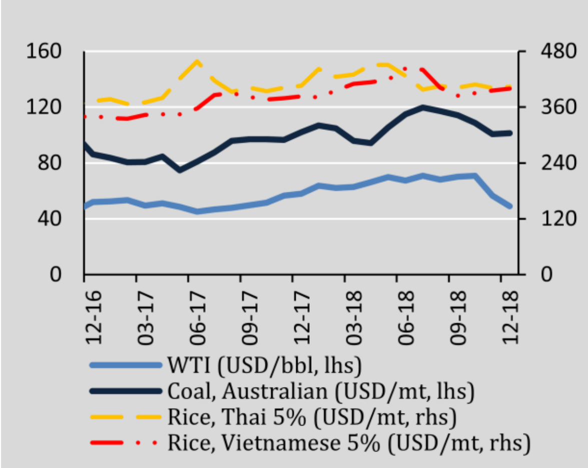
THE WORLD ECONOMY

Commodity and asset markets

Commodity market in Q4/2018 witnessed a decline in energy prices, while food prices did not fluctuate significantly compared to Q3.

WTI crude oil price in Q4 peaked in early October at nearly 77 USD/barrel, the highest level in four years. The main reason came from concerns about supply shortage when the US re-imposed sanctions on Iran's oil industry. Many experts at that time predicted crude oil prices would surpass 100 USD/barrel soon.

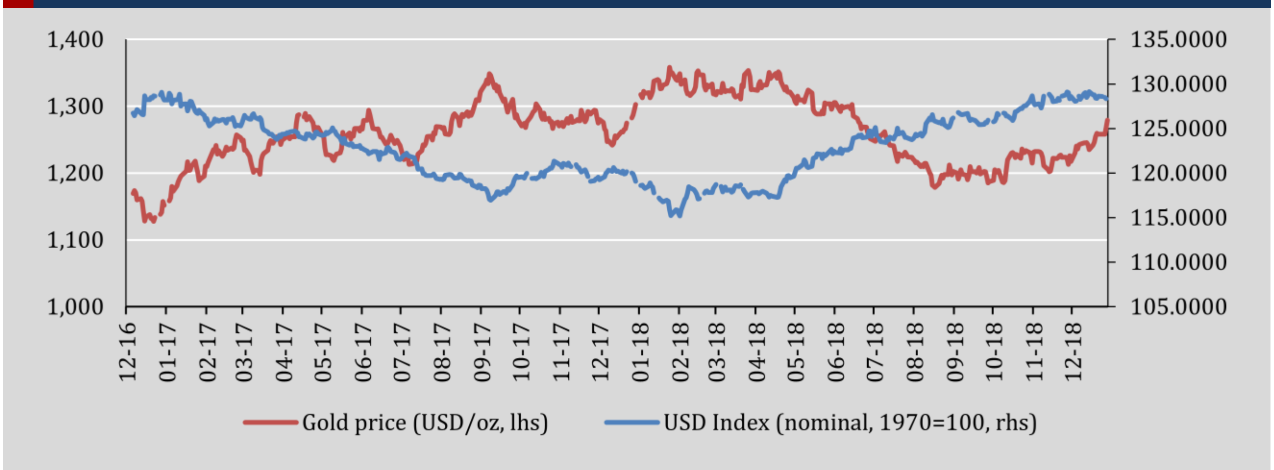
Commodity Prices



Source: The Pink Sheet (WB)

However, that was all the oil prices achieved in Q4. The rest of the year saw a sharp drop in crude oil prices. On December 24, WTI crude oil price was only 42.5 USD/barrel, hit bottom in a year and a half and lost nearly 45% of the value in October. The pessimism of international organizations on global growth prospects has led to a decline in crude oil demand. Besides, the concerns about the supply shortage were eased when the three largest oil producers, including the US, Russia and Saudi Arabia, are exploiting oil at the record or near record level. Moreover, the Donald Trump administration's sanctions on Iran's oil industry were less severe than expected by allowing eight countries keep buying Iranian oil for 180 days without any punishment. This move made the impact of sanctions on oil supply not as severe as previously forecast.

Gold Price and USD Index



Source: FRED, www.gold.org

For other energy commodities, Australian coal price in Q4 also witnessed a relatively sharp decline. The average price in the last two months of 2018 was 100.7 and 101.4 USD/ton respectively, losing more than 15% of the value compared to the peak in July.

Regarding food products, Vietnamese and Thai rice prices did not fluctuate widely in Q4/2018. While Thai rice price went up and down continuously, Vietnamese rice price tended to increase after falling sharply in September. The reason came from rising demand while supply was quite limited in Q4. A highlight in 2018 was that Vietnamese rice price occasionally surpassed the Thai one in the market. At the end of 2018, Vietnamese and Thai rice prices averaged 399.5 and 404 USD/ton respectively.

The world stock market had a staggering year when strongly affected by the US-China trade war and the Fed's tightening monetary policy. The main indexes of US stock market including Nasdaq, S&P 500 and Dow Jones hit bottom on December 24, before recovering slightly in the last sessions of 2018. Overall, this was the worst year of the US stock market after the 2008-2009 financial crisis. For example, the S&P 500 index on December 24 only reached 2,351 points, down by 12.8% compared to the first session of the year. Meanwhile, Asian stock markets, especially the Chinese market, also plummeted as investors worried about the economic prospect. The MSCI Asia-Pacific Index excluding Japan hit bottom at 142.2 points on December 25, losing 24% from its peak in January. In China which suffered the most damage, the stock market lost more than 2 trillion USD in market cap in 2018, according to Bloomberg's estimates.

The year 2018 was a depressing year for the cryptocurrency market. The Bitcoin hit bottom on December 15 at 3,230 USD/BTC, losing more than 80% of its value from the peak of 20,000USD/BTC at the end of 2017. Coinmarketcap.com calculated that the market cap of the cryptocurrency market lost 730 billion USD as of mid-December compared to the peak in early January of 2018. The financial bubble has already burst, almost marking the collapse of this market.

In Q4, the USD value did not fluctuate strongly. The nominal USD index was in the range of [127; 129]. Overall, the year 2018 witnessed the movement against the weakening in 2017: the USD rose sharply after four times of the Fed rate hike. By the end of 2018, the nominal USD index reached 128.36, up by 8.2% compared to the beginning of the year. The appreciation of the USD also led to capital flow reversals from emerging economies, especially countries with weak macroeconomic foundations.

During Q1/2018 when gold price remained above 1,300 USD/oz, Ronald Peter Stoeferle, the fund manager at Incrementum AG, said that gold price would be able to exceed 1,500 USD/oz by the end of 2018. This prediction may be reasonable if one looks at developments on the Korean peninsula and investors' concerns about US-China trade tension in Q1. However, the appreciation of the USD was the main driving force behind the movement of the gold price in 2018, especially in the second half of the year. Strong USD reduced attraction to this safe investment option. Although the gold price recovered in the last months of the year, it did not reach the threshold of 1,300 USD/oz again.

In the world housing market, Asia is finally succumbing to the global property slowdown. The main reason is due to the declining demand from the important market forces - buyers from mainland China. This is the result from the slowdown of the mainland economy and the Chinese government's tightening control of capital outflows. In addition, IMF study (2018) shows that there is a growing "synchronization" of housing prices among major countries and cities. That means that when a shock hits the real estate market in a country (especially a large country), this is likely that instability will spread to many other countries. As IMF stated, "A simultaneous decline in house prices globally could lead to financial and macroeconomic instability." In China, housing prices are being maintained at an artificially high level to conceal bad debts and avoid the collapse of the banking system. If the real estate bubble bursts in China, it will create an economic disaster with this country and possibly the whole region.

The Fed continued monetary policy normalization

Source: BEA, OECD

The third estimate by the US Bureau of Economic Analysis (BEA) showed that GDP growth rate in Q3/2018 reached 3.5% (qoq). The positive growth of the US economy came from the recovery of the private sector and the expansionary fiscal policy (increasing spending and reducing taxes) of the government. According to estimates, the US economy in 2018 could grow by 2.9% (yoy). The Fed forecasts that the US economy in 2019 may only grow by 2.3% in the context of the global economic downturn.

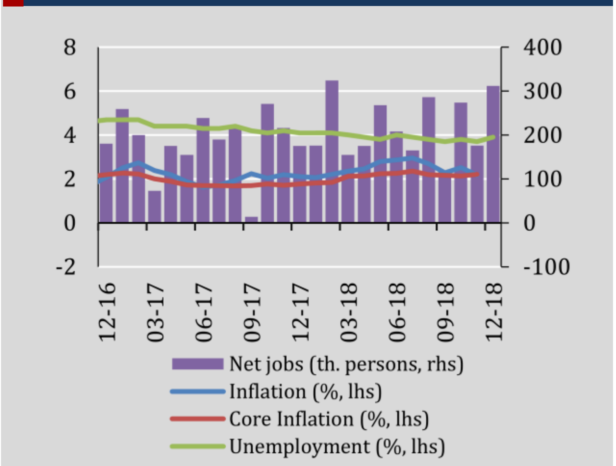
Regarding sectors, the service indicators still showed a positive outlook for this sector in Q4/2018. The NMI in October and November reached a very high level of 60.3 and 60.7, just below the record of 61.6 in September. At the same time, component indicators also maintained steady growth. Specifically, the two component indexes, the Business Activity and New Orders, reached 65.2 and 62.5 in November, even higher than in September.

Q4 saw the fourth and last rate hike of the Fed on December 19. Accordingly, the federal funds rate continued to increase by 25 basis points to 2.25% -2.5%. The economy in an intense growth period and a strengthened labor market were the main reasons for the Fed's decision to raise interest rates. Another important factor leading to the Fed's rate hike was that core inflation and headline inflation maintained above the 2% target since March 2018. In November, the US core and headline inflation reached 2.21% and 2.18%, respectively.

The "normalization" of monetary policy in 2018 aimed to counterbalance fiscal expansion, limiting the rising aggregate demand and control domestic inflation. In the future, the Fed will continue this task but perhaps with less frequency in the context of weakening world economic growth. Specifically, the Fed considered raising interest rates twice in 2019, instead of three times as stated earlier.

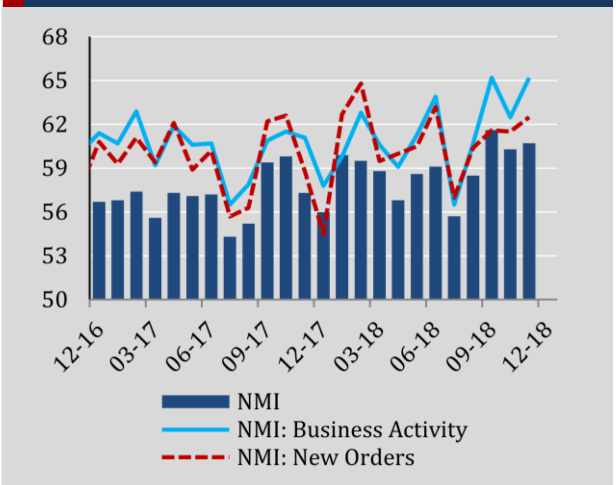
Meanwhile, according to the latest data from the US Bureau of Labor Statistics (BLS), the December unemployment rate rose back to 3.9%, after maintaining the 50-year low level of 3.7% in three months. The total number of new jobs in Q4/2018 showed signs of improvement, with more than 100,000 new employees compared to the same period in 2017 (762 compared to 662 thousand new jobs).

US Inflation and Unemployment (%, yoy)



Source: BLS

US Non Manufacturing Index



Source: ISM

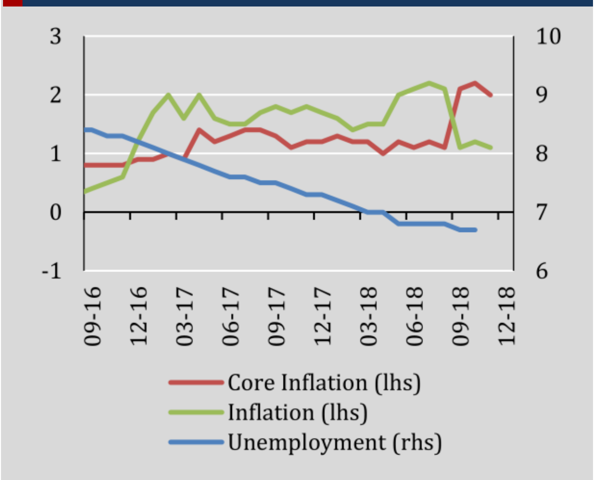
The trade war with China, though bringing much damage to its rival, also affected the US herself. The strong USD made imports of consumption goods soar, resulting in a growing trade deficit with a 10-year record of 55.5 billion USD in October (seasonally adjusted). Meanwhile, the US budget deficit also reached the highest level in the last six years. Specifically, the fiscal year 2018 (ending in September) saw a deficit of 779 billion USD. This was a consequence of the expansionary fiscal policy of the US government by reducing taxes for businesses and increasing spending.

EU Economy faced growth challenges

The European economy started to show signs of sharp economic slowdown in Q3/2018. Economic growth in Q3 of the EU28 and EA19 areas only reached 1.82% and 1.64% (yoy), the lowest growth rate in the last four years. The PMI of 2018 dropped continuously over months, showing a slowdown in the manufacturing sector. EU PMI in December only reached 51.4, compared with nearly 60 in early 2018.

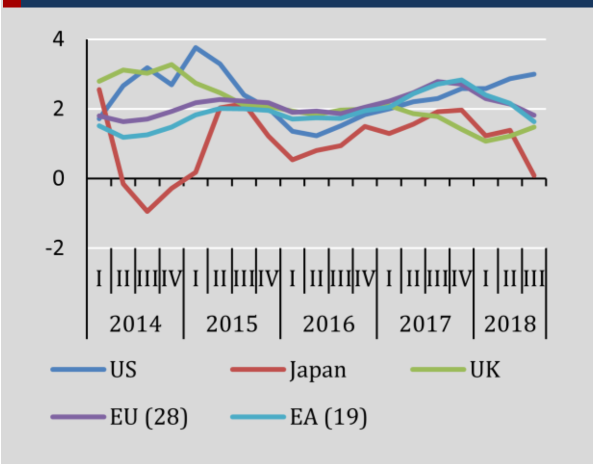
Employment situation continued to improve in Q4/2018. Unemployment rate (seasonally adjusted) reached 6.7% in October, the lowest level since this data began to be collected since January 2000. Meanwhile, the headline inflation and core inflation in Q4 remained stable as in the previous quarters. The headline inflation fluctuated around the 2% target, while core inflation continues to maintain around 1.1-1.2%. Along with the Fed, the European Central Bank (ECB) also entered the process of "normalizing" monetary policy by ending the quantitative easing package at the end of the year, although it may

Unemployment and Inflation in EU28 (%)



Source: OECD

Economic Growth in Selected Advanced Countries (%, yoy)



Source: OECD

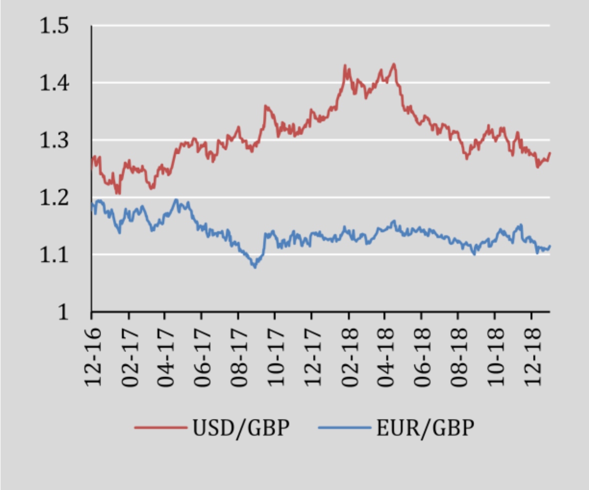
continue to keep interest rates low.

The UK economy in 2018 faced slowdown due to low labor productivity and Brexit-based instability. In Q4, the UK and EU governments reached a Brexit agreement in November 2018 but still had to wait for the UK Parliament to approve it. Although it has not officially left the EU, figures show that the UK economy has been and will be affected by Brexit. According to an estimate by Frankfurt Main Finance (FMF), 800 billion Euro of assets and 10,000 jobs will be transferred from London to Frankfurt before Brexit in March 2019.

Another European economy facing instability is France. The "Yellow-vests" movement began to erupt from November 17 to protest the government's plan to raise fuel taxes and demand improvement of people's living standards. However, the wave of protests quickly turned into riots and was out of government control. To deal with the situation, the French government announced a 12 billion Euro support package to support low-income people and pensioners and postponed plans to raise fuel taxes. The movement later spread to many European countries, mainly to oppose immigration policy and demand improvement of living standards.

After the first quarter when the USD was weak, the GBP for the rest of the year

EUR/GBP and USD/GBP exchange rates



Source: BoE

clearly showed depreciation against the USD. In addition to the strong USD, investors' worries about the lengthy Brexit negotiation process also affect the value of the British Pound. The USD/GBP exchange rate at the end of 2018 was 1.256 USD/GBP, down by more than 12% from the peak in April.

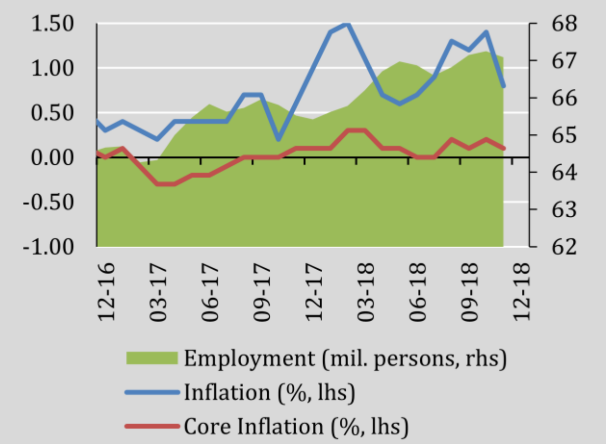
Challenges for the European region include Brexit; trade tension with the US; concerns about fiscal problems and public debt in member countries such as Italy and Spain; the rise of populism against the EU coalition. These could lead to the weakening EU with a lack of solidarity to deal with crucial political and economic issues.

Japanese economy suffered from the trade war

Data from the Japanese government showed that Japan's economy in Q3 declined by 0.6% (qoq), stronger than market expectations. The growth rate over the same period in 2017 was only 0.09% (yoy), after maintaining over 1% in two years. These figures may result from the impact of the US-China trade war as well as natural disasters.

The economic slowdown in Q3 was partly reflected in the growth of industrial production. Specifically, Japan's IPI in Q3 reached its lowest level in 2018. This index recovered relatively strongly in Q4, and therefore the Japanese economic situation may be better in the last quarter of 2018 when official data is released. Meanwhile, the service sector continued to remain stable, with the retail index increasing gradually at the end of the year and still above 100.

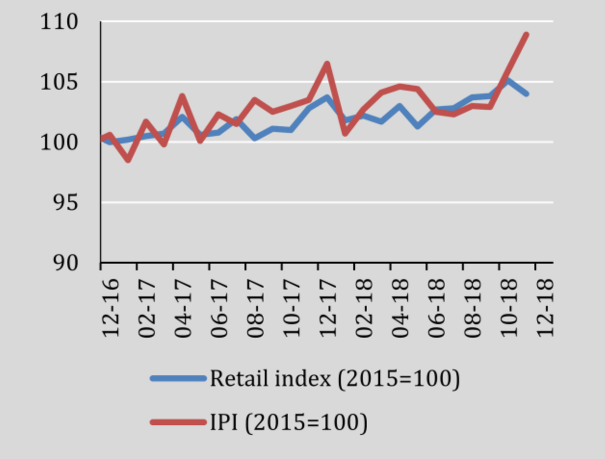
Japan's Inflation and Employment



Source: Statistics Bureau of Japan

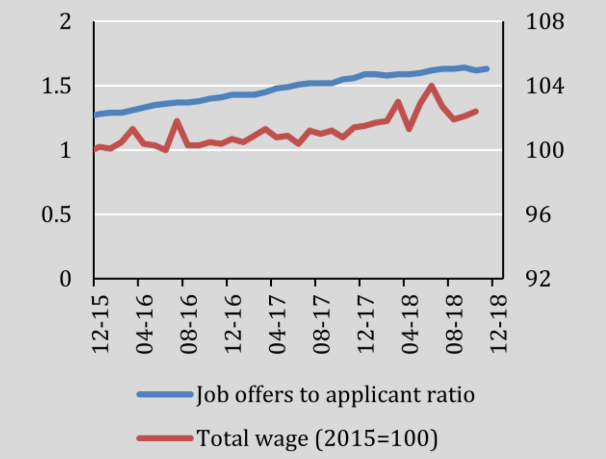
In June, Japanese exports to the US fell for the first time after 17 months. The situation was somewhat worse when export of the whole economy in September declined for the first time since November 2016, mainly due to the declining exports to the US and China markets. According to Takeshi Minami, chief economist at Norinchukin Research Institute, external demand likely

Japan's Retail Sales and Industrial Production (seasonally adjusted)



Source: Japan Macro Advisors

Total Wage and Jobs-to-Applicants Ratio in Japan



Source: Japan Macro Advisors

did not contribute to economic growth in Q3. Exports grew positively again in Q4, the same way as the manufacturing sector.

In the job market, the number of employed workers continued to improve, surpassing 67 million since September. The unemployment rate in 2018 remained low from 2.3 to 2.5%. Specifically, 2.2% of May was the lowest level in 25 years.

Meanwhile, the total job offers to applicants ratio remained the highest level over decades, at 1.62 from mid-2018. This number reflects severe labor shortages as Japan faces the problem of the aging population. Recently, Japan has passed a new law that allows skilled foreign workers in sectors suffering labor shortages to be granted a 5-year visa. This new law is expected to help Japanese companies quickly solve the problem of severe labor shortages due to the aging population.

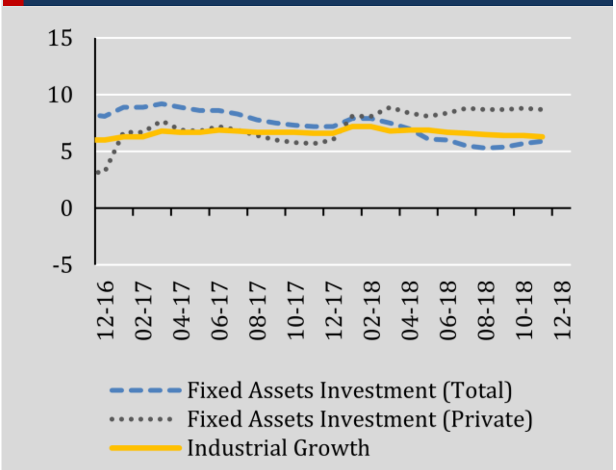
Meanwhile, headline and core inflation have not yet reached the 2% target set by the BOJ. Headline inflation in November even dropped to only 0.8%. BOJ's quantitative easing program has been going on for five years, and the 2% target seems to be too ambitious. Massive asset purchases made the bank's balance sheet assets exceed Japan's GDP. In the context of 2019 containing many macroeconomic risks, it is difficult for the BOJ to pursue the monetary easing program aggressively.

China's economy encountered difficulties

China's economy in Q3/2018 continued to face slowdown with a growth rate of 6.5% (yoy). This was the slowest quarterly growth in nearly ten years and lower than the forecast (6.6%). The US-China trade war was one of the main reasons leading to the decline of the world's second-largest economy. Figures below show that China is having problems and passive in controlling its economic growth. We believe that the economy of this country may slow down even more in the coming time.

Growth of social investment also witnessed a record low in Q3. In Q4/2018, China's investment growth recovered to some

China's Investment and Industrial Growth (%, yoy, ytd)



Source: NBS

extent. This may suggest that the country is increasing investment to boost growth as the economy is struggling against a slowdown.

When the economy decelerates, consumption will also decrease. Recent data shows that car sales dropped by 6% for the first time in 20 years. Goldman Sachs Group Inc. forecasted that the Chinese car market is entering a period of multi-quarter decline, and will decrease by 7% in 2019.

Meanwhile, industrial production growth in Q4/2018 continued to decline compared to the previous quarter and the same period in 2017, reaching only 6.3% in November. Along with that, the Q4 PMI also continued the downward trend. The December PMI index fell below 50, marking the contraction of the manufacturing sector after two and a half years of continuous expansion.

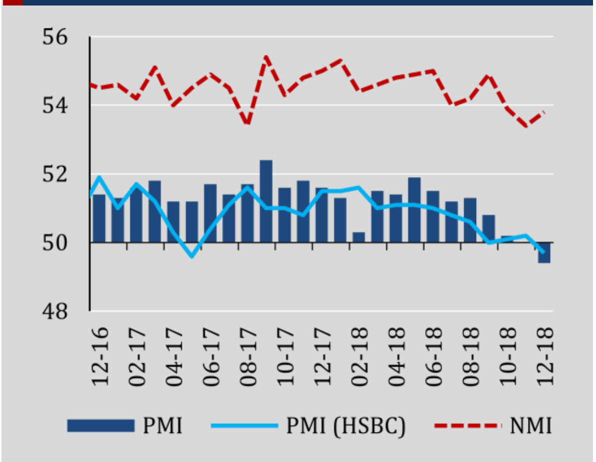
Continuing the trend of Q3, China's trade surplus with the US reached 35.6 billion USD in November and broke the record of monthly surplus. This paradox exists even when the tariffs of the two partners has officially become effective. It is possible that Chinese companies are concerned that their exported goods may be subject to even higher tax, and therefore continue to boost exports. However, trade tension showed signs of cooling down in December when the G20 Summit brought a truce in the US-Chinese trade war.

On the forex market, CNY continued to depreciate against the US dollar in October and remained more stable during the remainder of 2018. The CNY/USD exchange rate at the end of October was approaching the threshold of 7 CNY/USD, but then slightly decreased and ended the year at 6.9 CNY/USD. The weakening CNY may also be one reason for China's rising exports, creating a record trade surplus.

China's Exchange Rate and FX Reserves

Source: FRED, PBoC

China's PMI & NMI



Source: AASTOCKS

In 2018, China slashed banks' reserve requirement ratio (RRR) four times. On January 4, 2019, China continued to cut this ratio again to free up a net 800 billion CNY (116.5 billion USD) after lenders use some of the 1.5 trillion CNY in liquidity released to pay back maturing medium-term loans.

Increasing liquidity reduces capital costs for businesses and is expected to support the economy that is showing signs of strong deceleration. Although the PBoC Governor stated that he still applied a cautious and neutral monetary policy, this was a clear sign of monetary easing to support economic growth. This also shows that the Chinese government is worried about the deceleration of the economy that is going beyond their control.

One of the positive points of the economy was that foreign exchange reserves increased slightly at the end of 2018, from 3,053 billion USD in October to 3,072.7 billion USD in December. This may indicate that China has been more active in exchange rate intervention, not completely passive as in Q3/2018.

The US-China trade war and shift in global supply chain

It can now be seen that the so-called "US-China trade war" is not merely a consequence of the trade balance restructuring for the US economy, but the beginning of a bigger war to maintain American superpower and corresponding world order. A number of outstanding events that strained US-China relations over the past year strengthened this assertion: the arrest of Huawei's director, the USMCA agreement that regulates the "game rule" when a North American country engages in trade with a non-market economy (aimed at China) and a series of security and defense laws relating to the Indo-Pacific region.

This war, in addition to the direct impact on the world's two largest economies, also affects the future of the global economy. In the short term, trade war can undermine the world economy in general and global trade in particular. However, the more important impact of the war lies in the shift of global production & supply chain.

A less noticeable production shift is from the US to China. For example, Honda is switching to local production of a new version of an SUV model in China, rather than importing it from the US. The reason comes from the fact that vehicles imported from the US are subject to 40% tariffs amid escalating trade friction.

However, the more important production shift is from China to neighboring Asian countries. The US Chamber of Commerce in South China conducted a survey of Chinese businesses and foreign businesses operating in China. Of which, 60% of businesses will delay or cancel investment plans in China, and 70 % of US businesses surveyed will leave China. Viet Nam is one of the most ideal destination due to cultural and institutional similarities. Cheap, skillful labor and political-economic stability are also advantages of Viet Nam. In order to grasp this opportunity, Viet Nam needs to make great efforts to improving the institutional and business environments, and domestic labor quality.

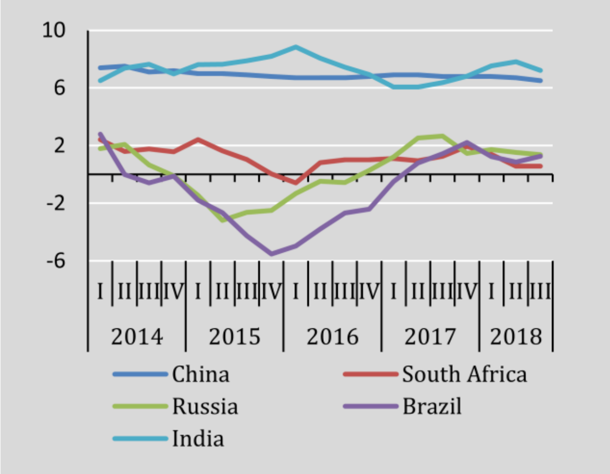
BRICS economies decelerated

Except for Brazil, BRICS economies witnessed a decline in growth in Q3/2018.

India's economic growth in Q3 fell to 7.23% (yoy), but it was still the fastest growing economy in the world. With positive growth over time, India's economic ranking will be improved quickly. The sudden drop in crude oil prices was favorable for the country's economy as India is the third largest oil importer in the world.

Russia's economy in Q3/2018 recorded a growth rate of 1.38% (yoy), lower than the previous quarters and equal to only half of the growth rate of the same period in 2017 (2.66%). According to the Russian Ministry of Economic Development, the deceleration came partly from relatively low output of agricultural products. Besides, Q3 also witnessed a gradual decrease in the IPI growth rate. The sudden drop in crude oil prices in Q4 would have a significant impact on the Russian economy and may force the country to cut oil exploitation to keep oil prices from falling further.

Economic Growth in BRICS (%, yoy)



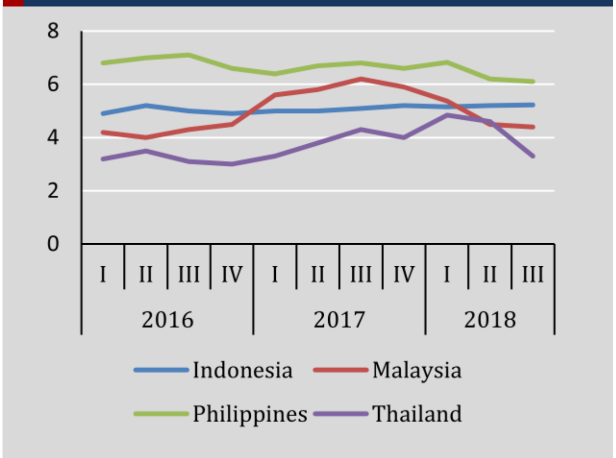
Source: OECD

ASEAN economy was not as positive as expected

In the context of escalating US-China trade war, the growth rate of the ASEAN-5 in Q3/2018 was estimated at only 4.7% (yoy), compared with 5.5% in the previous quarter. Many experts said that Southeast Asia would be the most benefited area if the trade war escalates. However, it may take time for these economies to feel that positive impact.

Indonesia was one of the emerging economies suffering from the worst currency crisis, under the pressure of the

Economic Growth in ASEAN-4 (%, yoy)



Source: CEIC

Fed's rate hike and current account deficit. In early October, the value of Indonesian Rupiah hit its 20-year low and surpassed the threshold of 15,000 Rupiah/USD. The exchange rate in the remainder of 2018 was relatively stable thanks to the efforts of the Indonesian government: raising interest rates, intervening in the foreign exchange market and imposing import restrictions to reduce the current account deficit.

The Philippine economy continued to show signs of deceleration when only growing by 6.1% in Q3/2018. The country also fell into a spiral of currency devaluation like many other emerging economies. In 2018, the Philippine Central Bank also had to raise its interest rate by four times to curb the depreciation of the Peso as well as rising inflation. The positive factor for the economy came in Q4 when the oil price suffered a sharp drop. This may reduce import costs and narrow the current account deficit.

Among ASEAN-5 economies, Thai economy faced the strongest deceleration in Q3 when it increased only 3.3% (yoy), much lower than the previous quarter (4.6%) and the same period in 2017 (4.3%). The main reason came from the weak demand of the world market under the impact of the US-China trade war. The PMI index also fell below the threshold of 50, reflecting the contraction of the manufacturing sector.

Global Economic Prospect (%)

	WEO (10/2018)			GEP (1/2019)		
	2017e	*2018p*	*2019p*	*2018e*	*2019p*	*2020p*
World	**3.7**	**3.7 (-0.2)**	**3.7 (-0.2)**	**3.0 (-0.1)**	**2.9 (-0.1)**	**2.8 (-0.1)**
Advanced economies	**2.3**	**2.4 (0.0)**	**2.1 (-0.1)**	**2.2 (0.0)**	**2.0 (0.0)**	**1.6 (-0.1)**
US	2.2	2.9 (0.0)	2.5 (-0.2)	2.9 (0.2)	2.5 (0.0)	1.7 (-0.3)
Euro area	2.4	2.0 (-0.2)	1.9 (0.0)	1.9 (-0.2)	1.6 (-0.1)	1.5 (0.0)
UK	1.7	1.4 (0.0)	1.5 (0.0)	1.3 (-0.1)	1.4 (-0.1)	1.7 (0.0)
Japan	1.7	1.1 (0.1)	0.9 (0.0)	0.8 (-0.2)	0.9 (0.1)	0.7 (0.2)
Emerging and developing economies	**4.7**	**4.7 (-0.2)**	**4.7 (-0.4)**	**4.2(-0.3)**	**4.2 (-0.5)**	**4.5 (-0.2)**
Russia	1.5	1.7 (0.0)	1.8 (0.3)	1.6 (0.1)	1.5 (-0.3)	1.8 (0.0)
China	6.9	6.6 (0.0)	6.2 (-0.2)	6.5 (0.0)	6.2 (-0.1)	6.2 (0.0)
India	6.7	7.3 (0.0)	7.4 (-0.1)	7.3 (0.0)	7.5 (0.0)	7.5 (0.0)
Brazil	1.0	1.4 (-0.4)	2.4 (-0.1)	1.2 (-1.2)	2.2 (-0.3)	2.4 (0.0)
South Africa	1.3	0.8 (-0.7)	1.4 (-0.3)	0.9 (-0.5)	1.3 (-0.5)	1.7 (-0.2)
ASEAN-5	**5.3**	**5.3 (0.0)**	**5.2 (-0.1)**			
Indonesia	5.1	5.1	5.1	5.2	5.2	5.3
Malaysia	5.9	4.7	4.6	4.7	4.7	4.6
Philippines	6.7	6.5	6.6	6.4	6.5	6.6
Thailand	3.9	4.6	3.9	4.1	3.8	3.9
Viet Nam	6.8	6.6	6.5	6.8	6.6	6.5
Laos	6.9	6.8	7.0	6.5	6.6	6.7
Cambodia	6.9	6.9	6.8	7.1	6.8	6.8
Myanmar	6.8	6.4	6.8	6.2	6.5	6.6

Note: ( ) show differences from latest forecast; e stands for estimates; p stands for prediction

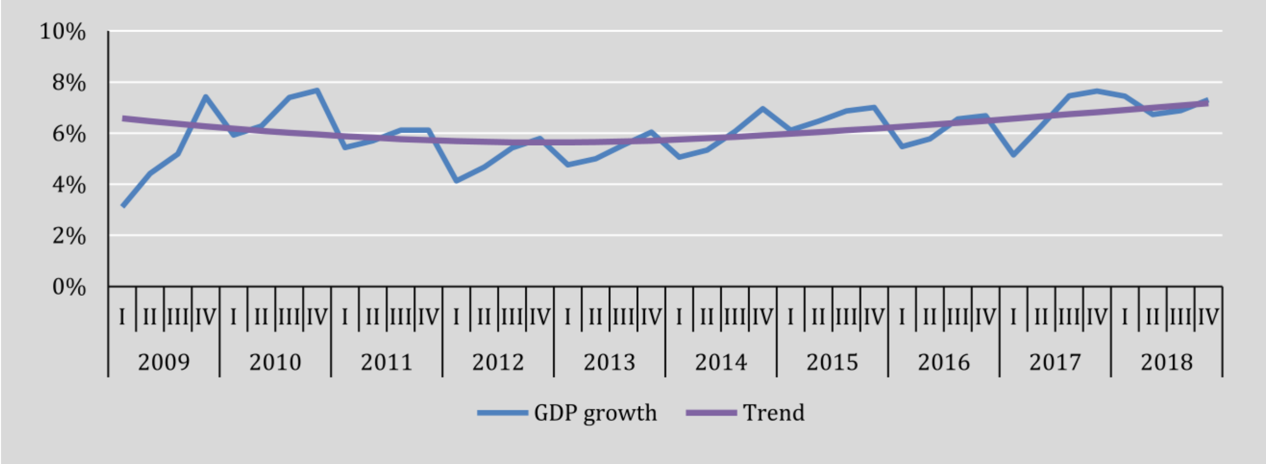
Source: World Economic Outlook (IMF), Global Economic Prospects (WB)

THE VIETNAMESE ECONOMY

Economic Growth and Inflation

Highest growth reported since the global financial crisis

Viet Nam's Economic Growth (%, yoy)

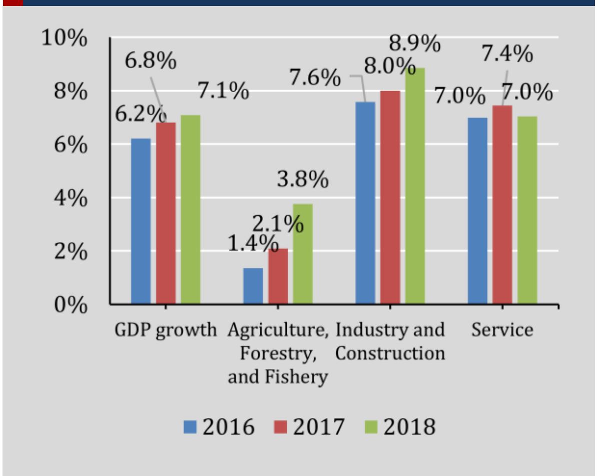


Source: Calculation from GSO data

Published data from GSO shows that the Vietnamese economy in Q4/2018 grew by 7.31% (yoy). For the whole of 2018, GDP was estimated to grow by 7.08%, the highest rate after the 2008-2009 financial crisis.

The service sector grew at 7.03% (yoy) in 2018, a relatively positive rate though lower than the same period in 2017 (7.44%). In particular, the wholesale and retail continued to be the fastest growing sub-sector (8.51%, yoy) and contributed the most to the overall growth of the economy (0.92 percentage points). Other sub-sectors such as finance, banking, and insurance, accommodation and catering services, real estate activities also contributed significantly. Notably, tourism continued to be a bright spot with the number of international visitors to Viet Nam in 2018 surpassing 15 million, up by nearly 20% compared to 2017, according to data from the Viet Nam National Administration of Tourism (VNAT).

Economic Growth by Sector, 2016-2018 (%, yoy)

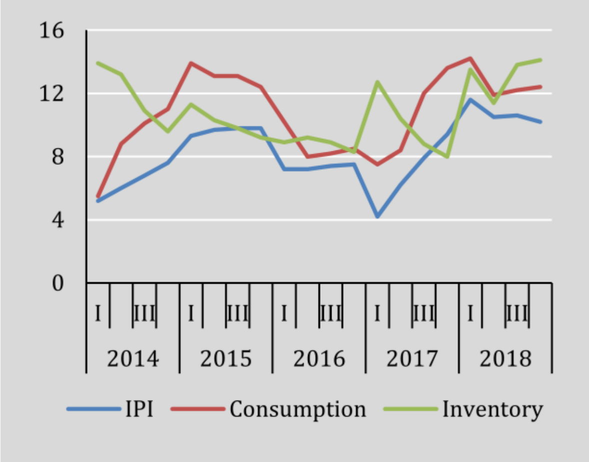


Source: GSO

The agriculture, forestry and fisheries sector witnessed a robust recovery with favorable factors from the weather and the world market. The growth rate of 3.76% (yoy) was the highest increase in the period of 2012-2018. In particular, the fisheries, especially pangasius farming, continued to be the bright spot of this sector thanks to strong external demand. As the US and China are both major export markets for agricultural, forestry and fishery products, the trade war between these two countries has also changed Vietnam's export structure. Specifically, from the time the trade war broke out in July to the end of October 2018, Vietnam's agricultural exports to the US increased by 15% (from 2.38 to 2.74 billion USD, yoy). Export of agricultural products to China was down by 13% (from 3.12 to 2.72 billion USD, yoy).

Meanwhile, the industrial and construction sector in 2018 grew by a relatively high rate of 8.85% (yoy), much higher than the same period of the previous years (2016: 7.57%; 2017: 8.00 %). This was also the sector that contributed the most to the economic growth in 2018. Manufacturing industry with flagship Samsung continued to be the main driving force of this sector with a high growth rate of 12.98%. Meanwhile, the mining industry still shrank by -3.11% (yoy), slower than the contraction of -7.1% in 2017. The reason came from the fact that crude oil price in 2018 was higher than expected.

Selected Industrial Indicators (%, ytd)



Source: GSO

Indicators of industrial production also continued to show optimism in Q4 and 2018 as a whole. In Q4 only, IPI increased by 9.4% compared to the same period in 2017. IPI for 2018 also grew by 10.2% (yoy). Of which, IPI of manufacturing industry continued to witness the highest growth rate of 12.3%. Consumption index kept improving, reaching an increase of 12.4% (yoy) for 2018. However, the inventory index continued to rise to 14.2% at 31/12/2018 compared to the same period in 2017. A high inventory index may have adverse effects, resulting in a temporary slowdown in production of the sector.

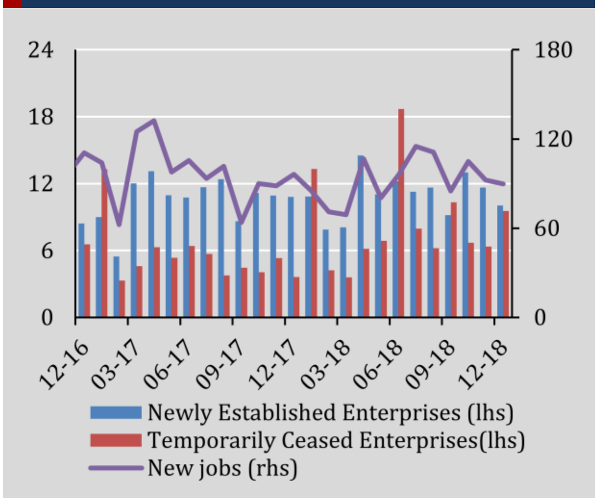
The number of temporarily ceased firms soared while the number of new jobs slightly decreased

In the context of high GDP growth, the Purchasing Managers' Index (PMI) in Q4 also showed signs of recovery, after falling sharply in September. In particular, November PMI reached 56.5, the second highest in history. PMI fell in December but still marked a 37th consecutive month of expansion. Prospects of the manufacturing sector in particular and the economy in general in the coming time are relatively bright.

The survey of business trends of manufacturing enterprises conducted by GSO continued to show the optimism of enterprises. Of all the surveyed enterprises, 44.7% rated their business performance in Q4 better than the previous quarter (the figure in Q3 was 43.1%). On the other hand, 16.9% of enterprises thought the business situation in Q4 was tougher than Q3. In the first quarter of 2019, 47.3% of surveyed enterprises are expected to rate the economic situation better.

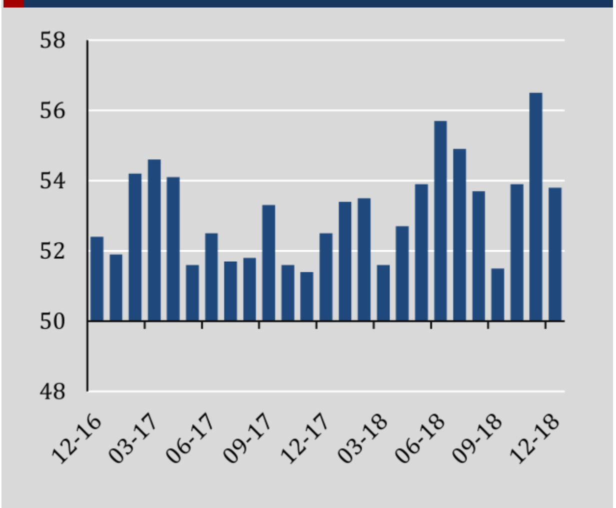
In the Ease of Doing Business Index (EBDI) Report published by the World Bank, Viet Nam's ranking fell one level to 69 out of 190 countries. The positive point is that Vietnam has implemented reforms on three criteria including: "Starting a business", "Paying taxes" and "Enforcing contracts" to make business activities easier.

Business Operations (th. units, th. persons)



Source: GSO

Viet Nam's PMI



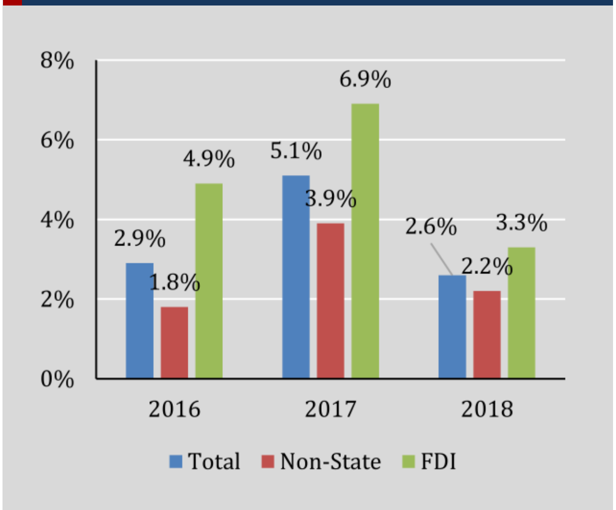
Source: Nikkei

Regarding business activities, the number of newly established enterprises in Q4 rebounded compared to September, averaging 11,555 per month. For the whole year of 2018, Viet Nam had 131,275 newly established enterprises, up only by 3.5% compared to 2017. The total registered capital was 1,478.1 trillion VND, up by 14.1% over the same period in 2017. The average registered capital per enterprise was 11.3 billion VND, up by 10.2% over the same period.

Meanwhile, the number of enterprises temporarily ceasing operation in Q4 continued to be abnormal compared to the same period in 2017, though less than in Q3. A total of 22,581 enterprises temporarily ceased operation in Q4, up by 74% compared with the same period of previous year. For the year 2018, the total number of temporarily ceased enterprises was 99,885, up by 51% compared to 2017. As mentioned in the previous report, the increase in this figure could make it difficult to reach the target of one million enterprises by 2020.

In terms of labor, new jobs created in Q4 increased slightly by 4.5% compared to the same period in 2017. In general, the quality of economic growth improved in the second half of 2018 as the number of new jobs higher than the same period in 2017. However, because the number of new jobs declined dramatically in the first half of the year, the total number of new workers in 2018 was 4.7% lower than in 2017. Regarding economic sector, labor growth in the state sector continued to decline by 0.7%, while in the non-state and the FDI sector witnessed growth rates of 2.2% and 3.3%, respectively. This shows that the FDI sector is still the fastest growing sector in all aspects (production value, export, job creation, etc.).

Labor Growth in Industry Sector (%)



Source: GSO

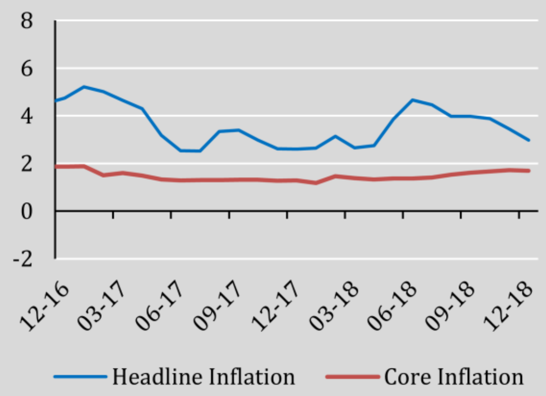
Headline inflation dropped in Q4, but core inflation continued to increase toward 2% target

Inflation showed signs of cooling down in Q4/2018. Contrary to previous concerns about high inflation risks in the last quarter of the year, an unexpected drop in energy prices from October contributed to moderate inflation. Inflation maintained below 4%, even less than 3% in December. For the whole year, the average inflation reached 3.54%, meeting the target set by the National Assembly.

One main reason for the CPI increase in 201 was the recovery of food and foodstuff prices compared to 2017. Pork price in 2018 increased sharply after reaching the bottom of 30 years in 2017 due to supply surplus. Besides, food prices also rose due to high demand from the world market. Overall, food and foodstuff group made the CPI increase by 0.61%. Before falling at the end of the year, world crude oil prices kept rising and peaking at four years. This led to the fact that the energy group still made the whole year CPI increase by 0.63%.

From January 1, 2019, the Ministry of Finance increased the environmental protection tax on petroleum products to 4,000 VND/liter. The low world oil price, together with the use of the stabilization fund, makes people temporarily not feel the impact of the tax increase. In the coming time when oil prices recover gradually, the impact will become more pronounced because the increase in gasoline prices often leads to a rise in other goods prices due to higher transportation costs.

Inflation (%, yoy)



Source: GSO

In addition, public services also contributed significantly to the CPI increase in 2018. Specifically, provinces increased the price of health services under Circular No. 02/2017/TT-BHYT of the Ministry of Health, resulting in an increase of 13.86% in the price of medicament group and 0.54% in the overall CPI. Meanwhile, the implementation of the tuition increase also increased the CPI of educational goods by 7.12% and the overall CPI by 0.37%.

Movements in 2018 showed a slight increase in core inflation. From 1.18% at the beginning of the year, core inflation increased gradually and reached 1.72% and 1.70% in November and December, respectively. This seems to show the SBV's monetary easing policy to support economic growth.

Macroeconomic balances

Trade surplus set a new record

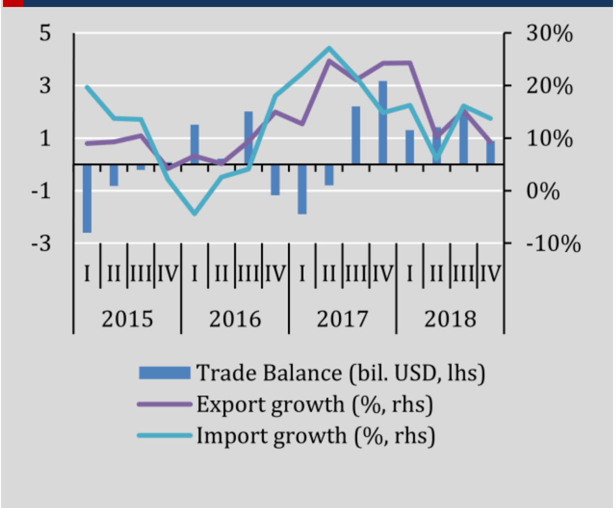
Trade in Q4/2018 continued to have positive progress, although it did not record a high growth rate like the same period of the previous years. Specifically, exports and imports increased by 9.2% and 13.7% (yoy), respectively. This was also the sixth consecutive quarter Viet Nam had a trade surplus with 0.9 billion USD.

For the whole year of 2018, the total trade turnover reached nearly 480 billion USD. The trade surplus was about 7.21 billion USD. The favorable trade balance contributed to the foreign currency supply to enhance the country's foreign exchange reserves in the first half of 2018, and together with the SBV's monetary policy to keep the exchange rate from fluctuating too widely in the second half of the year.

Export turnover in 2018 was estimated at 244.72 billion USD. In particular, exports from FDI enterprises accounted for a major proportion. Exports from this sector reached 175.52 billion USD, accounting for 71.7% of the total turnover and increasing by 13.1% over the same period in 2017. Exports from the domestic sector also improved significantly by 18.2% (yoy).

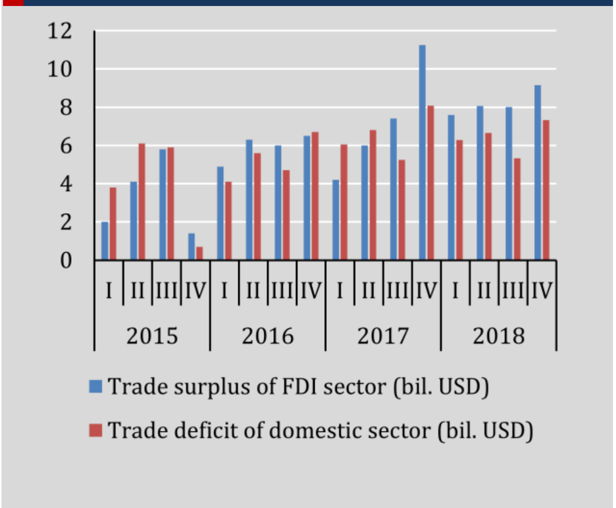
Meanwhile, total imports in 2018 grew by 12.5% and were estimated at 237.51 billion USD. Of which, imports of the FDI sector accounted for 142.71 billion USD, and the domestic sector was 94.80 billion USD. This led to a trade surplus of 32.81 billion USD in the FDI sector and a trade deficit of 25.60 billion USD of the domestic sector in 2018. The heavy dependence of the Vietnamese economy in general and the export area in particular on the FDI sector is also a weakness of the economy. Specifically,

Trade Balance and Growth



Source: GSO

Trade Balance by Sector



Source: GSO

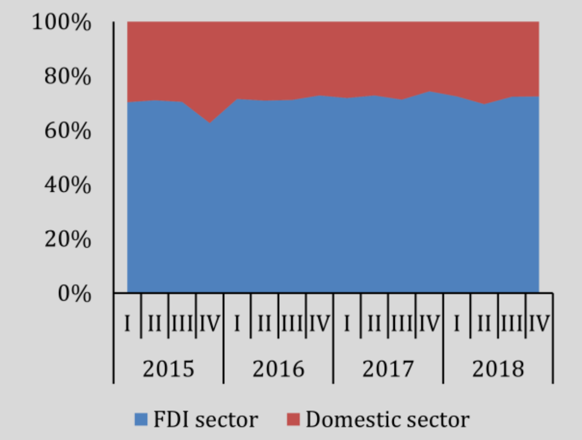
exports of the FDI sector is dominated by a number of large enterprises such as Samsung when the export turnover of phones and components alone accounted for 20% of the total export turnover of the year.

Regarding exported goods in 2018, there were 29 goods with export turnover of over 1 billion USD, and they together accounted for 91.7% of total export turnover. Of which, major commodities with high growth rate were: phones and components with 50 billion USD (mainly from Samsung as mentioned above), up by 10.5%; textiles and garments with 30.4 billion USD, up by 16.6%; electronics, computers and components with 29.4 billion USD, up by 13.4%; or footwear with 16.3 billion USD, up by 11%. Meanwhile, crude oil exports only reached 2.3 billion USD, down by 21.2% in value and 39.5% in volume. A volatile year of oil prices brought about the lesson about dependence on resource exploitation as this is an unsustainable direction.

Regarding imported goods in 2018, materials for manufacturing industry reached 217 billion USD, accounting for 91.4% of the total import turnover. In particular, the group of machinery, equipment, spare parts and group of raw materials had import turnover of 101 and 116 billion USD, respectively.

By trade partners in 2018, the US continued to be Vietnam's largest export market with a turnover of 47.5 billion USD (up by 14.2% compared to the same period in 2017). Part of the reason may come from Viet Nam benefiting from the US-China trade war when more US orders shifted from China to Viet Nam. Currently, China has risen to be the third largest export market of Vietnam, behind only the US and EU, and this was the factor that helped the trade deficit with China drop to second place, as described below. This is very important because it shows that China is increasingly inclined to be the consumer market for Viet Nam (because of high per capita income), especially agricultural products. So every change in the Chinese market like the trade war can have a significant impact on Viet Nam, and it had indeed.

Exports by Sector



Source: GSO

Meanwhile, China was still the largest import market with a turnover of 65.8 billion USD (up by 12.3%). The depreciation of CNY may be the cause, as we hypothesized in mid-2018 (in VEPR's Viet Nam Macroeconomic Report Quarter 2), making imported goods from China cheaper and thus penetrating the Vietnamese market.

South Korea has replaced China as the largest trade deficit partner with Viet Nam with 29.6 billion USD (followed by China with 23.9 billion USD). The high trade deficit with Korea came mainly from the fact that large FDI enterprises such as Samsung imported materials from South Korea.

In the coming time, US-China trade tension can bring great opportunities for the Vietnamese economy. In the short term, Vietnamese goods exported to the US may find some advantages compared to China-made goods. But goods exported to China may encounter difficulties. The combination of these two factors can bring structural impacts to Vietnamese exporters. In addition, the shift of investment waves and supply chain from China can help Viet Nam improve its trade balance more in the future.

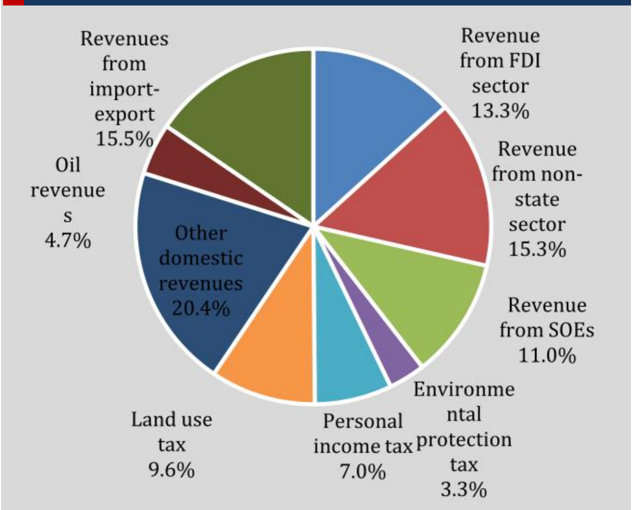
Budget balance keeps a significant deficit

Official data from the Ministry of Finance show that the state budget revenue reached 1.422 thousand trillion VND in 2018, exceeding 7.8% compared to the yearly plan.

Budget revenue increased significantly but still not enough for state expenditures, leading to a budget deficit of 3.6% of GDP. Meanwhile, the disbursement of investment capital showed no sign of improvement when only reaching 67.6% of the yearly plan (2017: 70.7%).

Fluctuations in state budget revenue and expenditure data over months did not reflect fiscal changes in Viet Nam as such data are temporary and will be significantly adjusted at the end of the year. In general, there have been no significant improvements in state budget structure compared to previous years with recurrent expenditure making up the majority and expenditure demand far exceeding revenues. In our opinion, if the Government does not curb public expenditure, measures of introducing new taxes or increasing current tax rates will remain prominent black spots of fiscal situation in the coming time.

Structure of Budget Revenue, 2018



Source: GSO

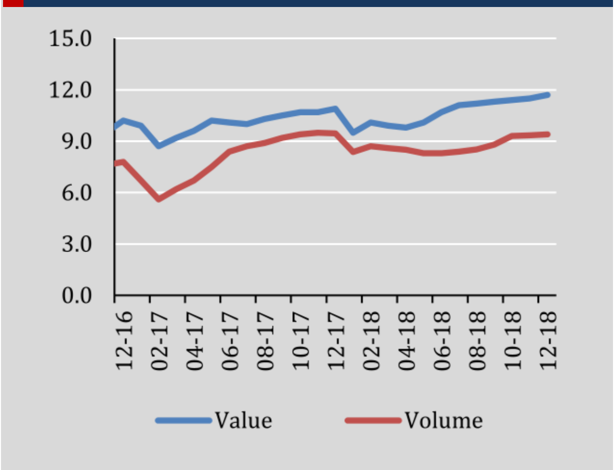
Consumption continued to remain stable, registered FDI decreased

Data from GSO showed that consumption continued to grow positively in Q4 and the year 2018. Total retail sales of goods and services in 2018 were estimated at 4,395.7 trillion VND, up by 11.7 % (yoy) compared to the same period last year. This growth rate was higher than the same period of the previous years (2016: 10.2%; 2017: 11.0%). At the same time, consumption was improved in volume, with a growth rate of 9.4% (yoy) excluding price factors.

In the retail industry, necessities that witnessed high growth rate were food and foodstuff (up by 12.6%); household appliances, tools, and equipment (up by 12.3%); and garment (up by 12.4%). In addition, gemstones, precious metals (13.8%) and wood and construction materials (13.7%) are also goods that saw significant growth rate.

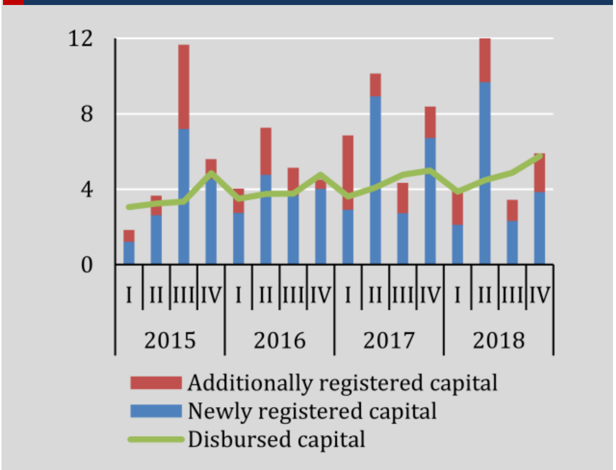
Meanwhile, the total social investment in Q4 continued to witness a recovery. Total investment capital of the entire economy in Q4/2018 was estimated at 603.4 trillion VND, up by 11.9% compared to the same period of 2017, the highest growth rate among the quarters of 2018. Of which, the non-state sector continuously experienced the highest investment growth in the year, reaching 19.6% (yoy) in Q4/2018. Meanwhile, the investment growth of the state sector continued to be below the double-digit level for nearly four years, partly reflecting the relatively slow disbursement of public investment.

Retail Growth (%, ytd, yoy)



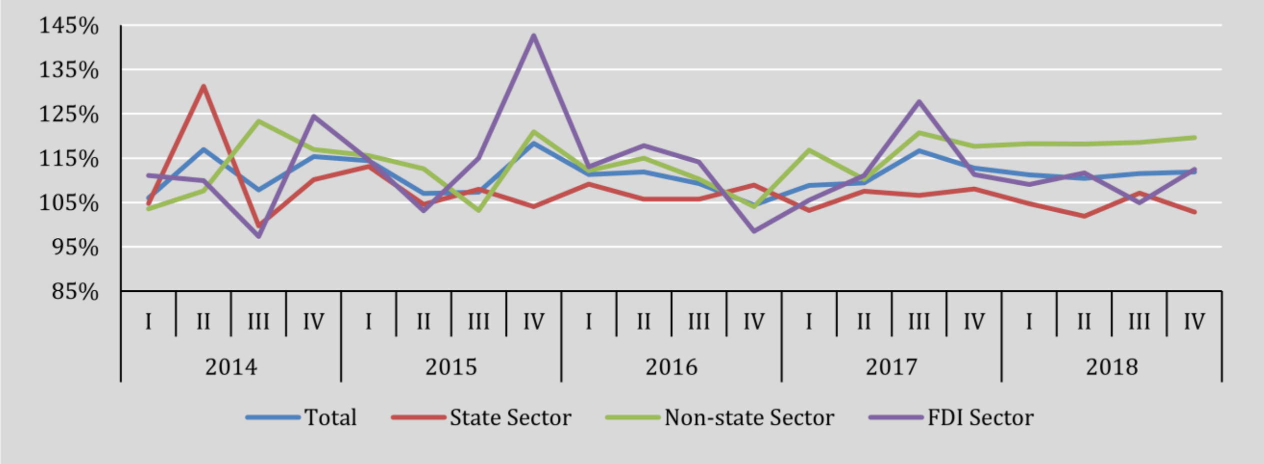
Source: GSO

Foreign Direct Investment (bil. USD)



Source: MPI

Total Investment (yoy), 2014-2018



Source: Calculation from the GSO data

Regarding FDI inflows, the disbursed capital in Q4/2018 reached 5.75 billion USD, up by 15% compared to the same period of 2017 and was the highest quarterly FDI disbursement in many years. Meanwhile, the newly registered capital was only 3.85 billion USD, down by 42.6% compared to the same period in 2017.

For the whole year of 2018, total disbursed FDI reached 19 billion USD, a yearly high record. High disbursed capital came from the abundant registered capital in previous years. Meanwhile, newly and additionally registered capital showed signs of going down when reaching 17.98 and 7.60 billion USD in 2018, down by 15.5% and 9.7% (yoy), respectively. Although it is unclear whether this is a temporary phenomenon or will continue under the instability of the world economy, this decline will more or less cause concern for policymakers when the growth momentum of the economy almost comes from the FDI sector.

In 2018, there were 3,046 new FDI projects, and one-third of them were in the manufacturing industry with a total newly registered capital of more than 9 billion USD. Large FDI projects in 2018 include Smart City project in Dong Anh, Hanoi invested by Sumitomo Group with a total capital of 4.14 billion USD, a project of polypropylene (PP) and liquefied petroleum gas (LPG) in Ba Ria-Vung Tau invested by Hyosung Corporation with a total capital of 1.20 billion USD.

Regarding investment partners, Japan was the number one investor in 2018 with a total registered capital of 8.60 billion USD and 429 new projects. The following positions were Korea (7.21 billion USD), Singapore (5.07 billion USD) and Hong Kong (3.23 billion USD). Accumulating by the end of 2018, Korea continued to maintain the number one position in FDI investment in Viet Nam with 62.57 billion USD, followed by Japan (57.02 billion USD).

The monetary and financial markets

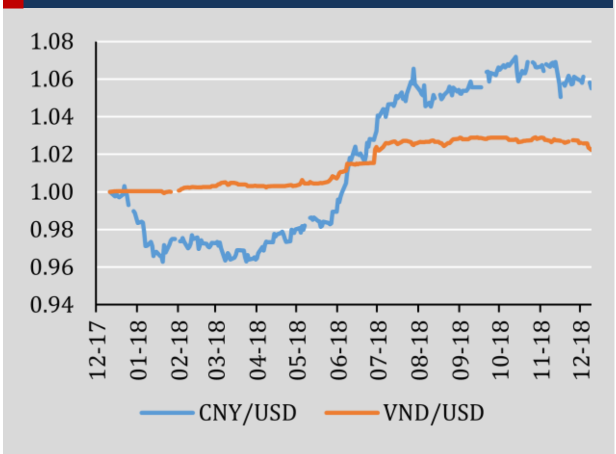
Wide fluctuations in the exchange rate

The fourth interest rate hike by the Fed on December 19 contributed to the appreciation of the USD against other currencies, including VND.

Like Q3, the VND/USD exchange rate at commercial banks in Q4 was very close to the ceiling level of 3% (compared to the central exchange rate) set by the SBV, although it eased in the last days of 2018. Accordingly, the exchange rate at VCB on December 28, 2018 was 23,245 VND/USD, up by 2.2% compared to the end of 2017. Meanwhile, the central rate of the SBV at the end of the year was 22,825 VND/USD, about 1.8% higher than the end of 2017. This fact shows that although the SBV has not officially stated, it devalued the VND with a relatively reasonable rate, similar to what VEPR recommended at the time of CNY began to depreciate against the USD.

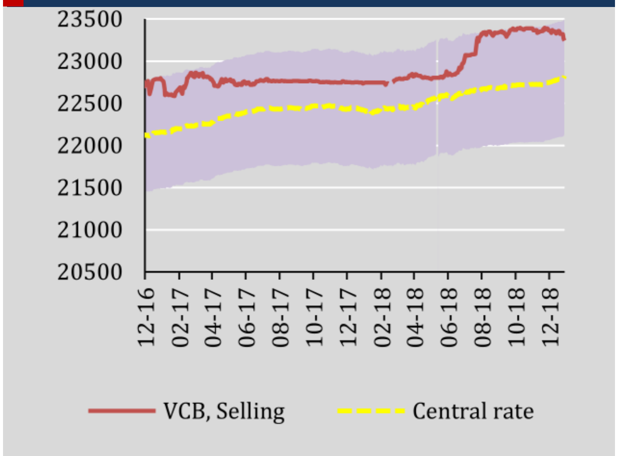
According to data from Ho Chi Minh City Securities Corporation (HSC), by the end of October, the SBV had to sell 5.3 billion USD since July to stabilize the exchange rate. The erosion of modest foreign exchange reserves (in terms of importing months) to protect the domestic currency is not a long-term solution. The official data on foreign exchange reserves since the SBV has intervened in the forex market was not published frequently, raising public concerns about the extent of intervention in the forex market and the remained policy space. According to the latest figures from the Governor of the SBV Le Minh Hung, Viet Nam bought a net of over 6 billion USD to replenish foreign exchange reserves in 2018. As recommended in the previous report, the SBV should regularly publicize data to enhance transparency and its

Depreciation of VND & CNY against USD, (29/12/2017=1)



Source: FRED, VCB

Nominal Exchange Rate (VND/USD)



Source: SBV, VCB

creditability on market governance. In addition, the big difference in the data on foreign exchange reserves published by the SBV and by international organizations such as IMF and ADB shows that data collection in Viet Nam is still not compatible with international practices. This may reduce the confidence of foreign investors about the SBV's ability to manage and stabilize the market when deciding to invest in Viet Nam.

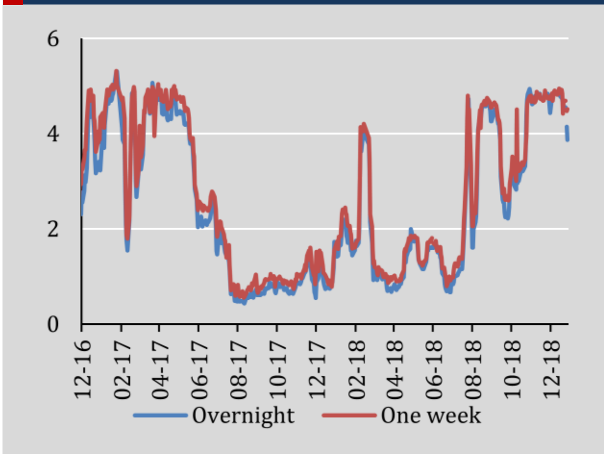
Liquidity of the banking system was opposite in the two halves of 2018

In the first half of 2018 when the VND/USD exchange rate was relatively stable, the SBV bought more than 11 billion USD to replenish foreign exchange reserves, and intentionally not strictly sterilized when withdrawing only 62.5 trillion VND via OMO and T-bill channels. The difference between deposit growth and credit growth (7.78% versus 6.35%) also made the liquidity of the banking system remain abundant.

In the second half of 2018 when the USD was strong, exchange rate pressure forced the SBV to sell foreign currency to keep the value of the domestic currency. Besides, the demand for capital often increases at the end of a year. These causes led to tighter liquidity. An inevitable consequence is that interest rates on the interbank market were pushed up. Overnight and one-week interest rates nearly reached 5.0%, even higher compared to the Lunar New Year in early 2018.

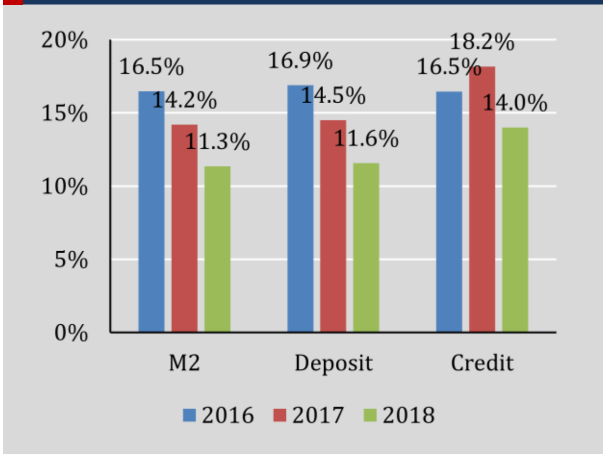
The tightness of the liquidity, along with rising inflation expectations, led to the fact that many commercial banks had to raise deposit rates in the first market. This caused concerns for enterprises about

Interbank Offered Rate (%)



Source: SBV

Growth of M2, Deposit, and Credit, 2016-2018



Source: GSO

rising borrowing costs, while the size of the corporate bond market was still modest (only about 7% of GDP, according to the report of the National Financial Supervisory Commission) and did not effectively share the burden with bank credit.

Credit growth in 2018 (about 14%, according to the Deputy Governor of the SBV Nguyen Thi Hong) was much lower than the target of 17% set at the beginning of the year. Credit intensity ratio decreased significantly compared to the previous period when economic growth still reached the highest level 10 years since the financial crisis. This may be a positive sign that the economy has relied less heavily on credit to boost economic growth while helping to reduce inflation risks.

In 2018, the Governor of the SBV approved Directive No. 04 on prudent management of credit in risky areas such as real estate and BOT, and more concentration on manufacturing. However, according to the report of the National Financial Supervisory Commission, the proportion of credit poured into real estate was even higher than in 2017 (not including the credit under the form of consumer credit). This suggests that the SBV needs to have stronger measures to control credit poured into risk areas strictly.

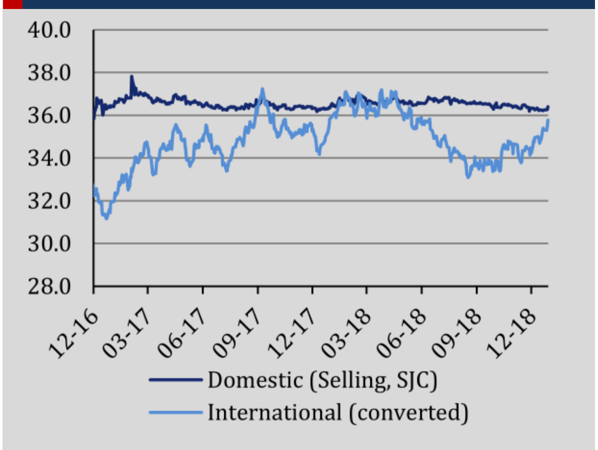
In 2018, although the total means of payment increased slowly (2016: 16.5%; 2017: 14.19%; 2018: 11.34%), the ratio of M2 / GDP was still about 170%, according to the data from the IMF. Along with the fact that the SBV still keeps the interest rate low, this makes room for monetary policy narrow.

Asset markets

Domestic gold price was out of tune with world price

The world gold price in 2018 rose and fell erratically due to the impact of the trade war and especially the strong USD. World gold price increased slightly in Q1 before plummeted in Q2 and Q3. Gold price fluctuated around the bottom before gradually recovering at the end of the year, but could not regain the peak of the beginning of the year. Meanwhile, domestic gold only showed a slight downward trend during 2018 but in general remained relatively stable compared to the world price.

Gold Price (mil. VND/tael)



Source: SJC, www.gold.org

Domestic gold price only fluctuated in the range of 36.2-37 million VND/tael for the whole year. Meanwhile, the world gold price at the beginning of 2018 even surpassed the domestic one, before hitting bottom during mid-year with 3.5 million VND/tael lower than the domestic price. This continues to reflect a lack of connectivity between the domestic and the world markets.

Apartment market was less active

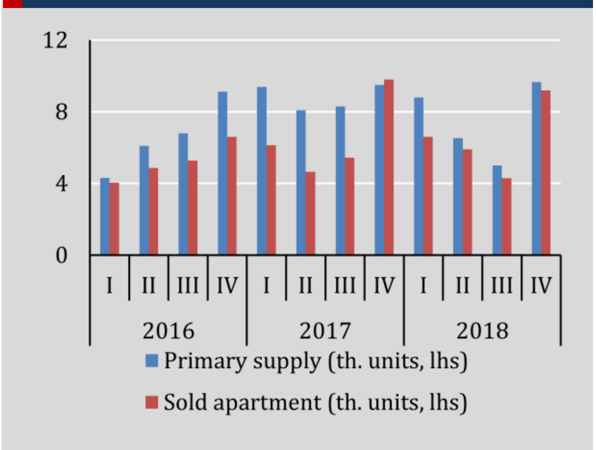
The real estate market had a relative recovery in Q4/2018, especially in Hanoi. However, due to the decline of the market during two quarters of mid-year due to the impact from the fire at Carina Plaza at the end of Q1, the total number of apartments for sale and successful transactions throughout the year were lower than 2017 in both areas. According to data from CBRE Viet Nam, transactions decreased by 11% and 12% compared to 2017 in Hanoi and HCMC market, respectively.

While still dominating the market in 2018, the mid-end segment showed different trends in the two areas. Specifically, the mid-end segment accounted for 52% (2017: 64%) of the new supply in HCMC, while this rate increased from 63% to 70% in Hanoi.

Besides, the real estate market is still attractive to foreign investors in Viet Nam compared to the same period of the previous year. According to the Foreign Investment Agency of Ministry of Planning and Investment, in 2018, the real estate sector still ranked second after manufacturing industry in terms of registered FDI, with 6.6 billion USD, accounting for nearly 20% of the total FDI capital in Viet Nam.

Directive 04 on tightening credit in risk areas such as real estate made more difficult for real estate projects to approach credit. Besides, the capital flow from China slowed down due to the internal difficulties of the economy, which causes common effects on Southeast Asia and may also affect the Vietnamese market as well.

Hanoi's Apartment for Sale



Source: CBRE

HCMC's Apartment for Sale

Source: CBRE

PROSPECTS FOR THE VIETNAMESE ECONOMY IN 2019 AND POLICY NOTES

The year of 2018 witnessed the uneven and unsteady recovery of the world economy. While the US underwent a high growth rate, other developed economies and emerging countries had their own problems. In addition to the different trends of growth among countries, the process of "normalizing" monetary policy in the US and Europe was also another remarkable event in 2018. Finally, the US-China trade war was escalating, completely changing the picture of the global economy.

Like 2017, Viet Nam in 2018 completed the socio-economic targets set by the National Assembly. Annual GDP growth reached 7.08%, the highest in 10 years after the financial crisis. PMI index in recent months reached the highest level in ASEAN. Meanwhile, the large trade surplus of the FDI sector continued to show the sector's leading role in trade. On the other hand, it also shows the weakness of the economy and more or less poses questions about the direction of the economy in the future when it is increasingly dependent on the FDI sector.

Inflation Q4/2018 tended to cool down thanks to a sudden drop in energy prices, contributing to the average inflation of below 4% target. In the context of erratic movements of world oil prices, the pressure on the SBV in the coming time to stabilize prices and curb inflation is not small, especially when environmental protection

Growth-Inflation forecast 2019

The 14th National Assembly's sixth session passed the Resolution No. 69/2018/QH14 and set key economic development targets in 2019 as follows:

	2019
GDP growth rate (%)	6.6-6.8%
Average CPI (%)	4%
Export growth (%)	7-8%
Trade deficit/Total export turnover (%)	<3%
Total social development investment (% GDP)	33-34%
Urban unemployment rate (%)	<4%

Source: Resolution No. 69/2018/QH14

The VEPR research team believe that goals for 2019 are achievable. The GDP growth rate could eve surpass the target in the context that Vietnam is benefiting from the US-China trade war. However, inflation risks still need to be closely monitored due to erratic movement of prices in the world commodity market.

Given this situation, we forecast economic growth rate and inflation in 2019 as follows:

Growth- Inflation in 2019 (%, yoy)

	Economic Growth	Inflation
Q1	6.61	3.25
Q2	6.72	3.72
Q3	7.01	3.10
Q4	7.12	4.28
2019	6.90	

Source: VEPR

tax became effective since January 1, 2019. This requires the SBV to control the money supply and credit in the coming time if it does not want inflation to go out of control.

The VND/USD exchange rate in 2018 was subject to depreciation pressures on the domestic currency as the Fed continuously raised the USD interest rate during the year. During the second half of the year, the VND/USD exchange rate was approaching close to the 3% ceiling (compared to the central rate) set by the SBV. The use of foreign exchange reserves to stabilize the value of VND recently is not a long-term solution when Vietnam's foreign exchange reserves are in fact small in scale (by importing months). In addition, exchange rate and inflation pressures, along with regulations restricting the use of short-term loans for medium and long-term loans, made the VND interest rates tend to increase significantly at the end of the year. However, raising interest rates will result in disadvantages for enterprises with higher borrowing costs when the size of the corporate bond market is still modest and does not reduce much of the burden for bank credit. Therefore, to adapt to the trade war, a prudent devaluation of the VND against the USD should be conducted at a lower rate than the depreciation of the CNY against the USD.

In 2018, the government and ministries showed their determination to reduce unnecessary business conditions to improve the business environment. Thousands of conditions were abolished to save time and unofficial costs for businesses. The World Bank's Ease of Doing Business Index (EBDI) also recognized Viet Nam's efforts to reform administrative procedures to create a healthier business environment. However, the number of business conditions that need to be removed is still substantial. If cheap labor and preferential policies on land and tax are the keys to attracting FDI enterprises, barrier removal and institutional reforms is a prerequisite for promoting entrepreneurship and the growth of domestic enterprises. In addition, the slowing down process of equitizing SOEs, along with the pressure to increase taxes, are always obstacles to long-term economic growth.

Viet Nam's economic prospects in the long term will continue to depend on FDI, removal of institutional barriers, improved business environment and equitization of SOEs. The State Capital Management Committee should focus on reducing management agencies, removing barriers to promote equitization, instead of trying to protect and maintain ineffective SOEs. International trade and investment activities are expected to flourish if free trade agreements (FTAs) such as CPTPP and EU are officially adopted. In addition, the US-China trade war is bringing Viet Nam a rare opportunity in the context that the supply chain is leaving China. However, to grasp this opportunity, Viet Nam needs to improve the institutional and business environment, and domestic labor quality.

In our opinion, one of Viet Nam's biggest problems lies in fiscal policy. In recent years, the budget picture and public debt have not been improved. The scale of public debt is large and close to the ceiling level (65% of GDP), creating huge burden of interest payment. Budget revenue is still only sufficient to finance state expenditures, without saving (having to borrow) to make development investment. The ratio of budget revenue/GDP has decreased slightly, but mainly due to the privatization of many public services. In particular, the state asset sector is declining through selling capital at SOEs or other state assets, but the budget deficit remains high (still about 4% excluding the principal payment). This means that Vietnam also lacks "fiscal buffer" to deal with external shocks (if any) like many other countries. The business environment is also difficult to improve when businesses and people always face with the worry of raising taxes to make up for the government's budget deficit.

In the process of "normalizing" monetary policy from developed countries and the risk of US-China trade war escalating in 2019, Viet Nam, on the one hand, should continue progress in improving domestic institutional-economic conditions, fiscal reforms and promoting the equitization of SOEs. On the other hand, it should focus on preparing financial, monetary and exchange rate conditions to be ready to face uncertainties from the world economy. These policies may include:

- Operate exchange rates flexibly in the direction of adapting (absorbing) external shocks. For example, a prudent devaluation of the VND at a lower rate than the depreciation of the CNY against the USD as VEPR once proposed is necessary for Viet Nam to adapt to the US-China trade war. Such adjustment of the exchange rate helps Vietnam take advantage of two large markets to improve production and trade balance.

- Deleverage, regulate and closely monitor to improve the health of the financial system. Although banks have made efforts to deal with bad debts currently, the risk of bad debt is still potential for Vietnam's financial institution system when credit flows into risk areas like BOT, real estate, and recently, consumer credit is still high. The recovery of loans from BOT and BT transport projects is not easy when many projects from these projects are repeatedly found to have major faults, making payback period longer than expected. As for the real estate sector, despite being more strictly controlled, the proportion of credit poured into the sector has increased (not including the credit under the form of consumer credit). When the real estate market becomes weak, the credit poured into it can become bad debts. In addition, consumer credit is gradually becoming one of the important drivers for the growth of the banking system. If not closely monitored, they are likely to become loan burden to pay for households when the economy suffers from shocks. Therefore, deleveraging and controlling credit within risk areas are essential to enhance the financial system's resilience against shocks.

- Be more prudent with money supply growth (controlling at around 12%/year). Although the total means of payment has tended to slow down in recent years, the ratio of M2/GDP of Vietnam is still about 170%. In the context that the SBV keeps the interest rate at a low level, lower money supply will help Viet Nam have more monetary policy space to cope with external shocks.

- Gradually build a fiscal buffer. In recent years, Viet Nam's picture of budget deficit and public debt has not improved much. As ODA loans become more and more limited, Vietnam must rely more on internal resources for development investment. This can only be done through personnel streamlining, restructuring the government apparatus to reduce recurrent expenditures. Thereby, the budget deficit will gradually be reduced and create a "fiscal buffer" to enhance the adaptability of the economy under the uncertain world economy.

Note: Long-term and structural policies will be discussed in other policy reports of VEPR.

Abbreviations

BoJ	Bank of Japan
BoE	Bank of England
CBRE	CB Richard Ellis Viet Nam
CNY	Chinese Yuan
ECB	European Central Bank
FDI	Foreign Direct Investment
FED	Federal Reserve System
FIE	Foreign invested enterprises
GDP	Gross Domestic Product
GSO	General Statistics Office
HSC	Ho Chi Minh City Securities Corporation
LHS	left hand side
IMF	International Monetary Fund
MOF	Ministry of Finance
MOIT	Ministry of Industry and Trade
mom	month-on-month
MPI	Ministry of Planning and Investment
OECD	Organization for Economic Co-operation and Development
PBoC	People's Bank of China
PMI	Purchasing Manager Index
qoq	quarter-on-quarter
RHS	right hand side
SBV	State Bank of Viet Nam
SOE	State-owned Enterprise
UN	United Nations
USD	the United States dollar
VAMC	Viet Nam Asset Management Company
VCB	Viet Nam Bank of Foreign Trade
VND	Viet Nam Dong
WB	World Bank
yoy	year-on-year
ytd	year-to-date

Disclosure appendix

Author's Certification

The following author who are primarily responsible for this report, certify that the opinion on the subject or issues and/or any other views or forecasts expressed herein accurately reflect their personal views and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this research report: Nguyễn Đức Thành, Phạm Thế Anh, Nguyễn Hoàng Hiệp (VEPR Macroeconomic Research Team).

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Additional disclosures

This report is dated as January 14, 2019. All data included in this report are dated January 11, 2019 unless otherwise indicated in the report.

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