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LAUNCHING

VIET NAM ANNUAL ECONOMIC REPORT 2015

"INTEGRATION OPPORTUNITIES, INTEGRATION CHALLENGES"

Time: 28th May, 2015

Venue: Red River Ballroom, Sheraton Hanoi

K5 - Nghi Tam, 11 Xuan Dieu Str., Tay Ho, Hanoi

08:00 – 08:30	**Registration**
08:30 – 08:35	Welcome and Introduction
08:35 – 08:45	*Opening Remarks by Assoc.Prof. Nguyen Hong Son, Rector of the University of Economics and Business, Vietnam National University, Hanoi* *Welcome Remarks by Mr. Hugh Borrowman, Australian Ambassador*
08:45 – 09:15	Introduction on the main contents of the Vietnam Annual Economic Report 2015 *Dr. Nguyen Duc Thanh – President of Viet Nam Institute for Economic and Policy Research (VEPR)*
09:15 – 10:00	Comments from Economic Experts 1. *Dr. Le Xuan Nghia – Senior Economic Expert* 2. *Dr. Le Dang Doanh – Senior Economic Expert* 3. *Dr. Huynh The Du – Academic Director of the Fulbright Economics Teaching Program*
10:00 – 10:15	**Tea Break**
10:15 – 11:55	Open discussion
11:55 – 12:00	Closing Statement by *Assoc. Prof. Nguyen Hong Son*, Rector of UEB, VNU

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VIETNAM ANNUAL ECONOMIC REPORT 2015

Edited by

Nguyen Duc Thanh & Nguyen Thi Thu Hang

INTEGRATION OPPORTUNITIES, INTEGRATION CHALLENGES

Hanoi, 2015

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INTEGRATION OPPORTUNITIES,
INTEGRATION CHALLENGES

Viet Nam Annual Economic Report 2015

INTEGRATION OPPORTUNITIES, INTEGRATION CHALLENGES

Contact:

Viet Nam Institute for Economic and Policy Research (VEPR)

University of Economics and Business, Vietnam National University, Hanoi

Address: Room 707, E4 Building, 144 Xuan Thuy, Cau Giay district, Hanoi, Vietnam.
Tel: (84) 4 37547506 – Ext: 704
Fax: (84) 4 37549921
Email: info@vepr.org.vn
Website: www.vepr.org.vn

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PREFACE

Viet Nam Annual Economic Report is a major product of one of Vietnam National University's key research directions and has been conducted annually since 2009 by the Viet Nam Institute for Economic and Policy Research of the University of Economics and Business. The primary purpose of the Report is to provide scientific evidence for macroeconomic policy-making for Vietnam based on reviewing and analyzing the major achievements, difficulties, opportunities, and challenges for the Vietnamese economy. In addition, the Report also discusses in-depth selected macroeconomic issues of the country while maintaining an objective and independent point of view.

As usual, around May, VEPR launches the Report, bringing researchers, policy makers, and Vietnamese readers the latest results after a year of meticulous research on macroeconomic situations and specific issues of Vietnam's economy. In-depth discussion in each chapter of the report, which results from modern approaches and is based on empirical evidence, statistics, and analysis that has been updated and thoroughly discussed, has increased the reputation of the Reports and helped them become the flagship, not only of VEPR, but also of Vietnam National University of Hanoi.

Though the Report is launched in the first half of the year, it thoroughly discusses fundamental economic issues for the whole year, and its forecasts exhibit a high degree of accuracy. The Report was developed by a team of renowned domestic researchers and foreign experts. During the process of publication, the Reports receive critique and suggestions, in many forums, from Vietnam's leading experts in macroeconomics, international economics, finance – banking, etc.

With significant contributions, the Reports have become a reference material for managers, policy makers, researchers, and those concerned with macroeconomic issues in Vietnam.

Given the 2014 Report focusing on the analysis and study of growth in the mid-term and long-term of Viet Nam, this year report focuses on the opportunities as well as challenges for Viet Nam when the country is accelerating towards a deeper global integration with many FTAs heading to the final rounds of negotiation. This tendency opens up many considerable chances for the socio-economic development of Viet Nam, yet it also raises fundamental questions such as whether the country is ready to truly integrate into the regional and global economy.

We believe that the *Viet Nam Annual Economic Report 2015: Integration Opportunities, Integration Challenges* will continue to bring to readers, who are familiarized with the Report series during the last five years, useful information, thoughtful questions, and provoking discussions on the fundamental issues of Vietnam's economy

.

Hanoi, May 25th, 2015

Phung Xuan Nha

President of Vietnam National University, Hanoi

ABOUT VEPR

VIET NAM INSTITUTE FOR ECONOMIC AND POLICY (VEPR), formerly known as Vietnam Centre for Economic and Policy Research, was established on July 7, 2008 as a research centre under the University of Economics and Business of Vietnam National University, Hanoi (VNU). VEPR has legal status and headquarters are located in the University of Economics and Business (UEB), Xuan Thuy, Cau Giay, Hanoi.

VEPR considers its primary mission as carrying out economic and policy research to assist in improving the decision-making quality of policy-making institutions, enterprises, and interest groups by providing insights into the social, political, and economic factors that drive the economic affairs of Vietnam and the region. The main activities of VEPR include (i) providing quantitative and qualitative analysis of changing economic conditions in Vietnam and assessments of their impacts on various interest groups throughout the country; (ii) organizing policy dialogues among policy-makers, entrepreneurs, and other stakeholders to improve solutions to emerging issues; and (iii) conducting advanced training courses in economics, finance and policy analysis regularly and upon request.

CONTRIBUTORS

Pham Van Dai: PhD candidate in Economics and Finance, Flinders Business School, Flinders University, Adelaide, Australia; expert of the Economic Research Department, Maritime Bank Vietnam.

Nguyen Thi Thu Hang: PhD in Macroeconomics and Finance at New York University, the United States. Nguyen Thi Thu Hang is the Chief economist of VEPR with expertise on macroeconomics, monetary policy, business cycle, imperfect information, and credit risk modelling.

Ken Itakura: PhD in Agricultural Economics from Purdue University, U.S.; expert in Applied Economic Modelling and GTAP model; Professor at Faculty of Economics, Nagoya City University; Member of American Economic Association, Japan Society of International Economics and Pan Pacific Association of Input-Output Studies.

Vu Minh Long: BA in Finance from La Trobe University, Australia; researcher at Viet Nam Institute for Economic and Policy Research (VEPR).

Dinh Tuan Minh: attended PhD Programme on Economics Studies of Technical Change in a joint research and training institute of United Nations University and Maastricht University; MA in Technological Economics from Asia Institute of Technology (AIT); experts on Austrian Economics School, public economics, institutional economics, economics of technology innovation and industrial organization. Dinh Tuan Minh is currently a senior researcher at National Institute for Science and Technology Policy and Strategy Studies (NISPASS).

Nguyen Thi Linh Nga: BA in Global Political Economy, School of Political Science and Economics, Waseda University, Japan; researcher at Viet Nam Institute for Economic and Policy Research (VEPR).

Nguyen Cam Nhung: MA In international Economics and PhD in Economics from the National University of Yokohama, Japan; lecturer of Economics and International Business, at the Economics University, Vietnam National University Hanoi.

Le Kim Sa: MA in Economics from Brown University, USA; PhD in economics at the Institute of World Economics, Academy of Social Sciences of Vietnam (completed training program as a graduate student at Georgetown University, USA); senior researcher and Vice Director at the Centre for Analysis and Forecast, the Academy of Social Sciences of Vietnam and Associate Editor of the Journal Asia - Pacific.

Nguyen Quang Thai: BA with High Distinction in Corporate Finance from School of Banking and Finance, National Economic University; awarded Third Prize in Ministerial Young Scientific Talent Award in 2012; researcher at Viet Nam Institute for Economic and Policy Research (VEPR).

Ngo Quoc Thai: BA in Economics from Australian National University (through the cooperation program with National Economics University in 2012); the 2nd prize (with no 1st prize awarded) in VEPR's Student Research Competition in 2010; researcher at Viet Nam Institute for Economic and Policy Research (VEPR).

Nguyen Duc Thanh: PhD in Development Economics from the National Graduate Institute for Policy Studies (GRIPS), Tokyo, Japan; member of the Macroeconomic Advisory Group (MAG) of the National Assembly's Economic Committee; member of the Macroeconomic Advisory Group for the Prime Minister; President of Viet Nam Institute for Economic and Policy Research (VEPR).

Hoang Thi Chinh Thon: MA in Economics with distinction from the National Economics University in 2011; lecturer of National Economics University; collaborator of VEPR, pursing a master degree at the Fulbright Economics Teaching Program, University of Economics, HCMC.

Nguyen Thanh Tung: BA in Economics at National Economics University, Hanoi; researcher at Viet Nam Institute for Economic and Policy Research (VEPR).

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ACKNOWLEDGEMENTS

Viet Nam Annual Economic Report 2015 by the Viet Nam Institute for Economic and Policy Research, University of Economics and Business, Vietnam National University, Hanoi is accomplished with the support from many individuals and organizations.

First and foremost, the authors would like to express gratitude to the Board of Presidents of Vietnam National University, Hanoi – especially President Phung Xuan Nha and Vice-President Nguyen Huu Duc, the Board of Directors of University of Economics and Business, especially Rector Nguyen Hong Son, those who have encouraged and enthusiastically supported the authors during the last six years to conduct the Report series.

One of the most important contributions that must be mentioned is from ***the Board of Advisors and Commentators***, who have participated in many discussions, workshops, and seminars during different stages of the Report. Thanks are due to Dr. Le Dang Doanh, Dr. Luu Bich Ho, Asoc. Prof. Dr. Le Bo Linh, Dr. Vu Viet Ngoan, Dr. Le Xuan Nghia, Prof. Dr. Sc. Nguyen Quang Thai, Dr. Vo Tri Thanh, Dr. Huynh The Du and Dr. Dinh Quang Ty for their deep analyses and constructive feedback of each chapter of the Report.

We are grateful to Department of Foreign Affairs and Trade, Australian Government for their generous support and cooperation for Vietnam Annual Economic Report.

We are greatly helped by VEPR staffs, especially ***the editing team*** and proofreaders. Their enthusiasm, dedication, and persistence are an indispensable part of this Report.

We would like to express our gratitude to the members of the Department of Science and Technology at Vietnam National University - Hanoi and Department for Research and International Relations at the University of Economics and Business for their enthusiastic support during the project.

Despite our efforts, we understand that there may be limitations and even errors in the Report. We sincerely hope to receive comments and contributions from the readers to improve our upcoming reports.

Hanoi, May 25th, 2015,
On behalf of the Contributors**,**
Dr. Nguyen Duc Thanh

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LIST OF ABBREVIATIONS

ABS	Asset Backed Security
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
AGIMEX	An Giang Import Export Company
APEC	Asia-Pacific Economic Cooperation
ARIMA	Autoregressive Integrated Moving Average
ASEAN	Association of Southeast Asian Nations
BIS	Bank for International Settlements
BOJ	Bank of Japan
BRER	Bilateral Real Exchange Rate
BSC	BIDV Securities Company
C.I.F	Cost, Insurance and Freight
CAR	Capital Adequacy Ratio
CCI	Consumer Confidence Index
CEIC	Euromoney Institutional Investor Company
CGE	Computable General Equilibrium
CIEM	Central Institute for Economic Management
CNY	Chinese Yuan
CPI	Consumer Price Index
DFID	Department for International Development
DOTS	Direction of Trade Statistics
ECB	European Central Bank
ERER	Equilibrium Real Exchange Rate
EU	European Union
F.O.B	Free On Board
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investment
FED	Federal Reserve System
FEER	Fundamental Equilibrium Exchange Rate
FMCG	Fast-moving Consumer Goods
FSAP	Financial Sector Assessment Program
FSIs	Financial Soundness Indicators
FTA	Free Trade Agreement
G2G	Government to Government
GDP	Gross Domestic Product
GMM	Generalized Method of Moments
GMP	Good Manufacturing Practices
GMP-RM	

GSO	General Statistics Office
GTAP	Global Trade Analysis Project
HS	Harmonized System
HSBC	The Hong Kong and Shanghai Banking Corporation
IEA	International Energy Agency
IFS	International Financial Statistics
ILO	International Labour Organization
IMF	International Monetary Fund
INSEE	French National Institute for Statistics and Economic Studies
IP	Intellectual Property
IPI	Index of Industrial Production
IPSARD	Institute of Policy and Strategy for Agriculture and Rural Development
JA	Japan Agricultural Cooperatives
JICA	Japan International Cooperation Agency
LDP	Liberal Democratic Party
M&A	Mergers And Acquisitions
MAFF	Ministry of Agriculture, Forestry and Fisheries
MBS	MB Securities
MITI	Ministry of International Trade and Industry
MOF	Ministry of Finance
NFSC	National Financial Supervisory Commission
NGO	Non-governmental Organization
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
OLS	Ordinary Least Squares
OPEC	Organization of Petroleum Exporting Countries
PBC	People’s Bank of China
PD	Probability of Default
PMI	Purchasing Managers Index
PPP	Purchasing Power Parity
QE	Quantitative Easing
R&D	Research and Development
RCA	Revealed Comparative Advantage
RCEP	Regional Comprehensive Economic Partnership
REER	Real Effective Exchange Rate
RER	Real Exchange Rate
ROO	Rule of Origin
RWA	RWA
SCP	Structure-Conduct-Performance
TFP	Total Factor Productivity
TNCs	Transnational Corporations
TPA	Trade Promotion Authority

TPP	Trans-Pacific Partnership Agreement
TPSEP	Trans-Pacific Strategic Economic Partnership
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNU-WIDER	The United Nations University, World Institute for Development Economics Research
USD	United States dollar
USDA	U.S. Department of Agriculture
VAMC	Vietnam Asset Management Company
VaR	Value-at Risk
VAR	Vector Autoregression
VAT	Value Added Tax
VCBS	Vietcombank Securities
VFA	Vietnam Food Association
VNCB	Construction Bank
VND	Viet Nam dong
WB	World Bank
WDI	World Development Indicators
WGC	World Gold Council
WIPO	World Intellectual Property Organization
WPI	Wholesale Price Index
WTO	World Trade Organization

EXECUTIVE SUMMARY

The content of the *Viet Nam Annual Economic Report 2015*, in addition to two chapters evaluating and commenting on the world and Viet Nam's economic situation in 2014, is devoted to the analysis of specific issues of Viet Nam when the country prepares to take a further step into the integration and globalization process. These include gains and losses when the TPP is concluded; instability behind the country's exchange rate policy when Viet Nam is integrating more deeply into international trade; problems of Viet Nam's rice market structure; and the vulnerability of the banking sector under hypothetical events or scenarios in the coming time. Finally, the Report presents general observations about the economic outlook for 2015 and suggests policies to support the country's upcoming integration process.

THE WORLD ECONOMY IN 2014 AND PROSPECT OF 2015

After six years, the worst effects of the global crisis have faded out among the countries but the world economy has not been able to achieve its peak performance as seen in the pre-crisis period and has moved to a "new normal" stage characterised by modest growth. The global economic growth in 2014 was slightly higher than in 2012 and 2013, but still fell significantly lower than the initial forecast launched earlier this year by international institutions like the IMF and the World Bank. Within the context of sustained low economic growth, global unemployment also has not improved yet. Alarmingly, youth unemployment has remained high since the crisis although there have been efforts to improve education for the young labor force. This is a warning situation because the cyclical unemployment has carried out for too long. That might be the cause of a gradual loss of job skills and become a contributor to structural unemployment.

Global trade is still depressed with low growth in 2014. In recent years, the production network of global value chains has been segmented, leading to a decrease in the value of global trade and reducing the trade elasticity to global incomes. In addition, the remarkable increase in the application of technical barriers on trade from the G20 from the end of 2008 has prevented the recovery of global trade. Several new factors unexpectedly arose which included the Ebola epidemic outbreaks in West Africa, armed conflicts in the Middle East, the prolonged oil price depression, geopolitical tensions between Russia and Ukraine and the West, and the currency fluctuations which have put pressure on global trade flows over the last year.

The steady fall of the oil price hit not only the current account balance of the OPEC members and several emerging economies such as Russia and Brazil, but also caused a major impact on state budgets of the countries in two ways. It was positive for countries with a large demand for imported oil and negative for those economies which depend on oil export revenues. Falling oil prices have also had a direct impact on prices and an indirect impact on many sectors such as transport, petrochemicals, agriculture and some manufacturing sectors. Thanks to lower fuel costs, along with further improvements in agricultural production and conditions of food supply, prices of most types of main products reduced. However, lower prices of inputs have increased fears of deflation for developing economies. As inflation fell below the 2% target in most major economies, their central banks decided to continue to maintain low interest rates in 2014.

As the global economic growth remained modest and fragile, the conflicts and geopolitical instability have also prevented the flow of foreign investment, especially from the developed countries which has mitigated the flow of global FDI. However, transnational M & A remained robust and recovery rose from 2011 to a peak at present. The TNCs have aggressively expanded their business strategies to make the total value of new investment deals rise slightly in the past year.

Mixed trends continue in 2015, which might lead to a mixed affect on world growth in general and Viet Nam in particular. First, the US is expected to tighten monetary policy by interest rate instruments in June 2015. That may cause certain pressure on the exchange rates for many countries, including Viet Nam where a stronger dollar would require the exchange rate policy to be more flexible. For foreign debt, if the US dollar rose sharply in the coming period, the dollar-debt may have to bear a higher cost.

Second, China's growth slowed in a more sustainable way which might help it maintain inflation at a low level so the countries which depend on exports from China, such as Viet Nam, will also benefit from low costs. However, the quality of products imported from China should be subject to tighter controls.

Third, the oil price in the future will gradually increase slightly due to world supply which has narrowed following the peak seen in early 2014. With this trend, the transportation from individuals and households to businesses will no longer benefit from the reduction in oil price seen in 2014. As both a producer and consumer of gasoline, Viet Nam’s state budget revenues from the export of crude oil will be improved. But as the price of petroleum products will tend to rise, the rising cost of production could put pressure on the consumer price index in 2015.

Fourth, as economic forecasts for the US, Europe and Japan, the largest trade partners of Viet Nam, tend to be more optimistic in 2015, this may be more favourable year for the export of goods from Viet Nam. However, Vietnamese enterprises still need to continue to improve the quality of their products to meet the demand in these strict markets with their system of technical barriers to trade.

Fifth, the political tensions in the East Sea has made FDI flows move out of China and shift to its neighbouring countries. In addition, the global M&A will continue to grow especially in the financial sector and made by TNCs from the developed economies and emerging economies. Therefore, Viet Nam needs to continue to improve the investment environment to become more competitive in embracing this trend. However, Viet Nam will also need to select FDI flows consistent with development plans and sectors, especially the selection of partners interested in agriculture, forestry and fisheries.

OVERVIEW OF THE VIETNAMESE ECONOMY IN 2014

Although the world’s economy recovered at an uneven rate, maintained a slow growth pattern and sluggish trade, the annual economic growth rate of Viet Nam in 2014 outperformed the government’s target and most forecasts. Being the main driver of growth, the industrial sector accelerated thanks to enhanced condition and improved, higher demand from both foreign and domestic markets. The economic structure showed several constrained that hindered economic growth. The long-term growth trend has not recovered to pre-2008 levels. Domestic firms struggled yet lagged behind the foreign sector in accessing resources and expanding production.

Although inflation has dropped to the lowest level since 2000, the improvement in consumption was inconclusive. Consumer confidence rose slightly in the second half of 2014, signalling signs of improvement in 2015. Investment and credit grew moderately. Investment was led by foreign sector, mainly in industrial manufacturing.

Macroeconomic balances saw less signs of stress. The balance of payments improved thanks to record surplus in current accounts and financial account. The foreign exchange reserve expanded markedly, which raise financial security. In contrast, the state budget could not reign in current expenditure, achieving lower budget deficit at the expense of development investment. Despite the narrowed deficit, the State budget remained unbalanced and unsustainable due to the structural deficit. New issuance of government bonds not only covered budget deficit but also rolled over matured bonds.

The State Bank cut the operating interest rates in March by 50 basis points. State-owned enterprises' privatisation was resumed although there were not any stocks tradable in the secondary market. The SOEs' initial public offering also did not attract foreign investors.

Credit growth slightly improved thanks to credit in foreign currency green-lighted by the State Bank after growth of credit in Vietnam dong fell behind expectation. Higher demand for foreign exchanges pressurized the State Bank to intervene using its reserve and raise the reference exchange rate by 1% in June. The appreciation of real exchange rate implied negative impact on exported goods.

The banking system underwent the restructuring process while there still remained uncertainty about the true soundness of banks. Non-performing loans might have reduced but remained above the safe threshold. The disposal of NPLs faced legal issues regarding the handling of collaterals in the form of land.

The domestic gold price declined due to falling demand for hedging against inflation and demand for investment due to the USD appreciation. The stock markets fluctuated widely, managed to rise after two cycles. The real estate market warmed up mostly in the affordable and social housing segments.

VIETNAM'S EXCHANGE RATE AND ITS IMPACTS ON THE DOMESTIC PRODUCTION

Estimating the equilibrium exchange rate is essential to design exchange rate policy and predict the movement of the actual exchange rate. Chapter 3 presents two methods to estimate the equilibrium exchange rate in Vietnam which are based on the purchasing power parity (PPP) and general equilibrium approaches. The regression method based on the general equilibrium approach appears to lead to better result than the real effective exchange rate proposed by the PPP approach. Nevertheless, both methods indicate the appreciation trend of VND over the period 2011-2014. It is found that VND is overvalued at 7-11% at the end of 2014.

While the growth-enhancing effect of undervaluation is recently at the centre of economic and policy debates, there is a consensus on the negative impact of overvaluation on economic performance in developing economies. For that reason, we argue for an appropriate process to attain the competitiveness of the domestic currency, at least at the equilibrium level. Consequently, the first step is to curb the appreciation trend of VND. It requires that the devaluation of the nominal exchange rate is not less than the gap between domestic and global inflation. Notably, because the equilibrium exchange rate is considered over the medium term rather than short term, overvaluation is not necessarily accompanied by a decrease in foreign reserve. Foreign reserve can be affected and increased by short-term factors such as international remittance and short-term foreign borrowing. Therefore, determining exchange rate police based on the position of balance of payments could result in disequilibrium and erosion of the economy's competitiveness.

Empirical analysis using the computable general equilibrium model shows that overvaluation negatively influences industries of which inputs are mainly domestically originated, for example agriculture, agricultural product processing, heavy industries, mining and light labor-intensive industries. Importantly, these industries play an essential role in reducing unemployment and improving the economy's productivity. On the other side, overvaluation helps boost consumption and industries of which production inputs are mainly overseas imported such as capital-intensive industries.

MACROPRUDENTIAL ANALYSIS FOR VIET NAM'S BANKING SECTOR IN 2015 - AN APPLICATION OF STRESS TESTING

While Viet Nam is integrating deeper into the world economy, the banking sector, as the blood stream of the economy, will have to face with many risks from macroeconomic instability, which may come from both internal capacity and external environment. The evaluation of the vulnerability of Viet Nam's banking sector, therefore, becomes important for researchers and policymakers to propose effective implications and adjustments, in order to avoid negative consequences to the economy in the future.

The key method to perform the evaluation is to construct stress tests to measure the vulnerability of the banking sector under hypothetical events or scenarios. These scenarios must be extreme/exceptional and plausible. On that basis, this chapter designs a framework for a solvency stress test to analyze 13 Vietnamese banks in 2015, which covers credit risk, exchange rate risk, interest rate risk, and security price risk.

The two scenarios are constructed by different approaches. The first one is based on 1% ‘tail’ events from a VAR model for macroeconomic variables like GDP growth, inflation, lending rates and nominal VND/USD exchange rate, and an ARIMA model for VN-Index. The second one chooses extreme episodes of the economy between QI/1996 and QIV/2014. After constructing these two scenarios, the authors estimate the capital adequacy ratio (CAR) for the selected banks, and the refinancing cost for the whole sector.

If no shock occurs, the economy might perform under the base scenario, and banks’ CAR are all higher than State Bank of Viet Nam’s required ratio of 9%. However, this will not happen in the two hypothetical scenarios. While in the first scenario only four banks still keep CAR at adequate level, the second scenario shows that no banks have CAR higher than 9%. In that case, State Bank of Viet Nam will have to recapitalize in order to avoid the collapse of the whole sector. Based on authors’ calculation, the recapitalization cost in the two scenarios will be about 1.50% and 2.97% of GDP in 2015.

Under the above results, the authors propose some recommendations for banks to improve their health under shocks, such as retaining more profits or mobilizing more capital from current shareholders and external investors. Banks can also reduce their risk-weighted assets by cutting high-risk assets and increasing low-risk assets, like collecting more debt, keeping more liquid assets and decreasing lending. Moreover, banks also need to undertake stress tests by themselves or provide information and data for supervisory offices or researchers. Finally, in order to avoid macroeconomic shocks, the banking sector should operate in a stable environment, which is a result of synchronous monetary and fiscal policies, in both short-term and long-term.

GAINS AND LOSSES FROM THE TPP: AN ASSESSMENT FOR VIET NAM USING GTAP MODEL

Viet Nam’s deeper integration into the global economy, especially when via such a comprehensive free trade agreement as the Trans-Pacific Partnership (TPP), brings various opportunities and challenges at the same time. Previous studies on impacts of the TPP on signatory countries gave a promising economic prospect for Viet Nam, which is going to be the largest beneficiary compared to other 11 TPP countries. However, in order to make the best of the opportunities and overcome the challenges, Viet Nam needs fundamentals changes in economic structure, institutions and governing policies.

This chapter attempts to make a quantitative evaluation of potential economic impacts of liberalizing trade in goods and services under the TPP on Viet Nam. Based on the recently published Global Trade Analysis Project (GTAP) Data Base version 9 and the GTAP model, we conduct a set of numerical experiments to simulate the economic effects arising from establishing TPP. We assume that bilateral tariffs on trade in goods among TPP member countries will be completely removed and the non-tariff barriers will be reduced for trade facilitation. These liberalizations of trade in goods and services would generate economic gains to the participating countries. It should be noted that TPP is expected to liberalize not only trade in goods and services but also investment and movement of labour, but our analysis is confined to the former due to the data limitation.

Despite employing a recently updated data base and constructing more realistic scenarios, this chapter provides relatively similar results to previous researches, confirming that Viet Nam will gain most in the TPP bloc in terms of the real GDP and economic welfare (in percentage change). In all three scenarios, Viet Nam is the economy experiencing the greatest percentage change in the real GDP, ranging from 1.03% to 2.11% increase, resulted mostly from the rise in investment and consumption. However, in absolute term, these figures can be translated into the gains of 1.4 – 2.9 billion USD, relatively low compared to the ones of Japan and Canada (in all scenarios) and also the US (in the two scenarios with service trade facilitation). Regarding investment, the gain for Viet Nam is the most outstanding among member countries, approximate to Japan and almost double Australia, Malaysia and the US (in scenarios without spillover effect of trade facilitation to non-TPP economies). In terms of trade, while exports observe a minor decrease, imports surge, resulting in a larger trade deficit for Viet Nam. Concerning the sectoral change thanks to the TPP, we observe an adjustment in Viet Nam's production and labour away from industries with eroding comparative advantage (such as agricultural sectors) and towards the comparatively advantaged ones (especially Apparel, Leather Manufacturing and Utility Services & Construction).

Based on the above findings, we would like to give the following policy implications:

First, this study again confirms the need of institutional reforms and liberalization of primary inputs such as labour, capital and land. Integration without those reforms will not only hinder Viet Nam from taking advantage of the opportunities, but also create negative impacts on its economic growth.

Second, once TPP is implemented, resulting in reduction in tax revenue, the government can try to offset the budget deficit by other sources. However, policies to improve the balance of payments need to be put into thorough consideration to achieve the macroeconomic stability, promote production and consumption, and avoid conflicts with other policies.

Third, Viet Nam needs to implement policies to foster sectoral restructuring in order to enhance the productivity. Besides, reasonable supports should be directed to industries with comparative advantage to improve competitiveness of domestic products and encourage exports, advancing Viet Nam's position in global value chains.

Fourth, FTAs nowadays do not only require the tariff removal but also concern about the non-tariff barriers such as transportation costs and customs procedures. Especially, on participating in TPP, Viet Nam also needs to adjust non-trade issues such as labour, intellectual property rights, etc. Therefore, the implementation of TPP commitments requires reforms in domestic policies and legal system.

Fifth, it is necessary to promote research, training, and implementation of suitable technical barriers in order protect domestic producers in line with supporting Vietnamese exporters in satisfying the demand of trade partners.

Finally, thanks to TPP, Viet Nam's investment (including domestic and foreign investment) will increase significantly. This is an opportunity and a challenge at the same time in attracting and utilizing the FDI inflows. Therefore, Viet Nam needs to implement administrative reforms, effective investment policies and accelerate the development of supporting industries to benefit from the TPP.

TOWARD THE SUSTAINABLE INTEGRATION OF VIETNAM'S RICE MARKET: A MARKET STRUCTURE APPROACH

Since late 1980s, Vietnamese rice sector has remained oriented toward increasing rice production and export, which has helped Viet Nam not only ensure domestic food security but also become one of the three biggest rice exporters in the world in the last decades. However, along with structural transformations in the international rice market, this orientation seems to mislead Vietnamese rice sector to many potential risks, such as low rice export prices with the continuing instability, putting the domestic rice market under the pressure of reducing prices; increasingly deteriorating soil quality; stagnant farmer households' welfare. These will surely challenge the sector's sustainable development. It is therefore high time for Viet Nam to determine precisely the major orientation of the rice sector to be readily adaptable to the world rice market characteristics, and implement reforms based on market stakeholders' performance toward the sustainable development of Viet Nam's rice market.

Chapter 6 applies Structure-Conduct-Performance (SCP) Framework of the industry organization theory to identify major Vietnamese and world's rice market characteristics. In the framework of SCP, market structure will define the stakeholders' conduct, and the stakeholders' conduct will determine their performance in the market. In addition, other factors such as market entrance barriers, the speed of the demand growth, and investment costs also affect the power and performance of the market stakeholders.

The analysis of the international rice market structure indicates that in the long-term, the rice export supply will be likely to surpass the demand. The reason is that while many countries importing rice like the Philippines and Indonesia endeavor to implement self-sufficiency strategies, countries like India, Cambodia and Myanmar with their own export potential are accelerating rice production. Furthermore, rice consumption in Asian countries is expected to peak in 2030, then remain unchanged or decrease slightly. Therefore, Viet Nam's rice sector should transfer its orientation into strongly developing domestic rice market. The domestic market ought to perform an important role in building and testing quality standards, band name as well as place of origin of the rice grains produced in Viet Nam.

After identifying the market structure, conduct and performance, we note the natural development potential of the milling firms which could accumulate the capital, establish vertical linkages to become enterprises with specialized rice producing zones, modern processing facilities and stable output market. These millers are encouraged to abide by GMP-RM and be self-responsible for using rice separators based on world standard of rice separation process. Furthermore, to develop domestic rice market, we recommend abolishing VAT on domestic rice consumption to achieve the equality between domestic wholesalers and exporters; add the irrigation system depreciation to the rice prices, especially the export rice prices.

Regards to the segment of trading paddy rice, to improve the farmer's efficiency and power, we analyzed and figured out the need for developing the adequate microfinance and insurance system for farmers; easing the harvest area limit for each household, which would encourage the land accumulation for farmers to cultivate in large-scale areas. The research also suggests the government implement more flexible policies towards the reserved 3.8 million hectares for rice cultivation, widening the opportunities for farmers to use the land more effectively. As for the segment of trading rice, for enhancing the market efficiency, the conditions on rice exporters need to be eased. Besides, VFA should be reformed toward assuring the participation and the voice of the representatives of private enterprises, local authorities and farmers in the association. Based on changes in world's rice market, the decision of VFA must be prompt enough to ensure firms' and farmers' interests. VINAFOOD I and II ought to focus solely on implementing policies (such as to co-ordinate and supervise the rice purchasing for the food security storage policy), while diminish their share of commercial distribution towards giving all of this playing ground for private companies.

VIET NAM ECONOMIC PROSPECTS 2015 AND POLICY IMPLICATIONS

In addition to medium-term policies that taking into account policy implications suggested within each chapter of the Report, chapter 7 presents two forecasts on Vietnam's macroeconomic prospects in 2015 and a comprehensive discussion on short-term policies adopted at the moment.

The year 2015 will be a remarkable year as it marks a number of milestones in Viet Nam's integration process since the accession to WTO in late 2007. The highlights include: signing of the EU – Viet Nam Free Trade Agreements (EU – VN FTA), basic conclusion of the TPP negotiation rounds, and the ASEAN Economic Community (AEC) coming into effect. The Viet Nam's highpoints of integration will make broad impacts on the Vietnamese economy in the medium and long terms.

Regarding the internal economy, there are two major issues in 2015. *First*, budget deficit is rising due to difficulties in maintaining and improving revenue, coupled with weak efforts in cutting expenditures. This exposes the Government to difficulties in mobilizing fund to finance the deficit. If the National Assembly cannot reach to an agreement about raising the quantity of bonds or public debt ceiling, the Government may be driven to find temporary fund from the State Bank of Viet Nam in a number of ways, though they are in the domain of monetary measures rather than fiscal measures. In that case, it leads to a risk of breaking the restraints of the monetary and fiscal discipline, which will create a dangerous precedent. The immediate impact of these choices is the deterioration of market confidence on the monetary policy and the transparency of fiscal policies. Second, the exchange rate of VND/USD has been kept stable in nominal term, from which the real appreciation of VND accrued. This trend has stealthily deteriorated the competitiveness of domestically-made products as well as services, such as tourism.

It is important to note that, these two issued appears to be unrelated but turns out to be strongly correlated with each other, especially in case of adverse shocks. For example, if financing budget deficit triggers a moderate increase in inflation in 2016, it could raise the depreciating pressure. Moreover, if the depreciation is too small, it will probably create a cycle of inflation – depreciation that would break the current macro balances.

The two scenarios show that the annual economic growth in 2015 will maintain the momentum accrued since 2013. Against the backdrop of temporary stability, the two scenarios relatively converge. The low scenario forecasts the economic growth at 6.1% while the higher forecasts an annual growth of 6.3% (2010 prices). The end-of-year inflation rate is expected to be low at 1,9% in the former scenarios while in the latter scenario, heightened economic activities may drive inflation to 3.2% as inflation will accelerate during the second half of 2015 and 2016. This is the case of a new cycle of inflation – depreciation mentioned above. The second scenario looked not different from the first scenario, but it implies a significantly higher degree of risks that may be presented in 2016.

Regarding fundamental issues of the economy, it is important to note that

- Given the vulnerability of the banking system, banks may not withstand extreme but plausible shocks. It remains uncertain about the financial soundness of each bank (information asymmetry); Besides,

- Orientating production and export industries needs to be more marketized to enhance the competitiveness and the strength of enterprises. Take rice production industry for example, it is recommended to ease the condition for exporters, increase the role of endogenous factor (miller enterprises) to create a foundation for intra-industry vertical integration and form the competitiveness of the industry

- Viet Nam's benefit from joining TPP is going to be positive and fundamental, which will impact on the economic structure through multiple of channels of effects in industries and areas. The benefit will be greater if the endowments such as capital, labour and land are flexible to move. This correlates strongly with administrative and institutional reforms.

Based on those issues, a number of related policies are highlighted:

- Flexible monetary policy to realign the VND; maintain or build up forex reserves to strengthen the confidence in monetary policy.

Carry on reforms and restructure of the banking system to create a premise for the recovery of profit margin and recapitalization of the banking system. Restructure high-risk portfolios.

Apply technical barriers to trade for imported goods and raise awareness about technical barriers erected by export markets

Strongly reform the internal institutions to enhance the flexibility of endowments which will facilitate cross-border movements

Nevertheless, the long-term issues are raising productivity and added value. They requires simultaneous reforms in administration, institution and schemes in each enterprises to increase its productivity and efficiency.

Beside the medium and long-term policy recommendations mentioned above and policy discussions in great detail in each chapter of the Report, Chapter 7 proposes another integration initiative. In order to be more involved in the integration process, as well as to reap more benefit from the freedom of navigation and marine security, we recommend Viet Nam to proposal for an establishment of the Pan–Asia Marine Economic Cooperation – PAMEC). This organization should aim to build a hi-quality marine infrastructure, connecting most significant marine economies between the Indian Ocean and the Pacific Ocean, establishing a united bloc for common prosperity and security. PAMEC can be built on the basis of these potential founding member candidates (alphabetical order): Australia, Canada, China, Japan, India, Indonesia, New Zealand, Malaysia, Myanmar, Philippines, Singapore, Sri Lanka, Taiwan, Thailand, Vietnam, and the United States.

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Australian Government
Department of Foreign Affairs and Trade

Australian Aid

Vietnam Annual Economic Report 2015

INTEGRATION OPPORTUNITIES, INTEGRATION CHALLENGES

Ha Noi, May 28, 2015

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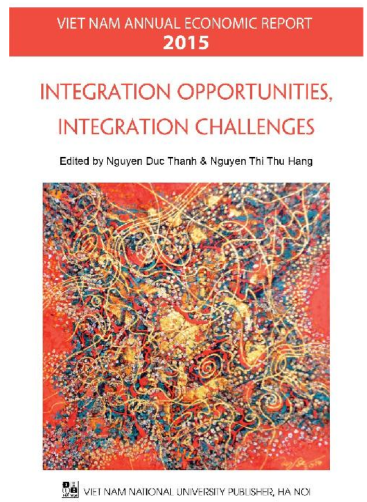
The Context of VAER 2015

- A number of progressive reforms were enacted in 2014. Their impacts, however, will depend on the instructions from the central authority and the implementation of the local authorities.
- A number of free-trade agreements were in the final rounds of negotiation, raising the question on whether Viet Nam is ready to take a further step in its integration into the regional and global economy.
- Recent fluctuations of the global economy have shown that geo-political instabilities can lay a strong impact on the oil price and global trade, causing unexpected negative shocks which can affect to the budget and other macroeconomic balances.
- The government continued to deliver strong messages for institutional reforms in order to further integrate into the global economy, improve the quality of growth, and raise the country's competitiveness. Nevertheless, there are still many constraints in the implementation process.



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VEPR Contributors

1. Pham Van Dai, MA
2. Nguyen Thi Thu Hang, PhD
3. Ken Itakura. Prof.
4. Vu Minh Long
5. Dinh Tuan Minh
6. Nguyen Thi Linh Nga
7. Nguyen Cam Nhung, PhD
8. Le Kim Sa, PhD
9. Nguyen Quang Thai
10. Ngo Quoc Thai
11. Nguyen Duc Thanh, PhD
12. Hoang Thi Chinh Thon
13. Nguyen Thanh Tung

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Nguyen Quang Thai, Prof, Dr.Sc.
Vo Tri Thanh, PhD
Le Le Thuy, PhD
Truong Dinh Tuyen, Mr.
Dinh Quang Ty, PhD

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Chapter 1:
Overview of the World Economy in 2014

Nguyen Cam Nhung
Le Kim Sa

VEPR Contents

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The global economic growth shifted to a "new normal" stage

The worst impacts of the global financial crisis faded away. The world economy moved to a "new normal" stage, with lower growth rate than the pre-crisis level.

Table 1.1. Economic growth, 2012-2014 (%)

	IMF			WB		
	2012	**2013**	**2014**	**2012**	**2013**	**2014**
World	3.2	3.0	3.3	2.5	2.4	2.6
Developed economies	1.4	1.3	1.8	1.5	1.3	1.8
US	2.8	1.9	2.4	2.8	1.8	2.4
Japan	1.4	1.5	0.1	2.0	1.7	0.2
Europe	-0.7	-0.5	0.8	-0.6	-0.4	0.8
Germany	0.9	0.5	1.5	0.7	n.a	n.a
France	0.0	0.3	0.4	0.0	n.a	n.a
Spain	-1.6	-1.2	1.4	-1.6	n.a	n.a
Italia	-2.4	-1.9	-0.4	-2.0	n.a	n.a
Emerging economies	5.0	4.7	4.4	4.8	4.8	4.5
China	7.7	7.7	7.4	7.7	7.7	7.4
India	4.7	4.4	5.8	5.0	4.8	5.6
ASEAN-5	6.2	5.2	4.5	n.a	n.a	n.a
Russia	3.4	1.3	0.6	3.4	1.3	0.7
Brazil	1.0	2.3	0.1	0.9	2.2	0.1

Note: ASEAN-5 includes Indonesia, Malaysia, Philippines, Thailand, Vietnam

Source: IMF(10/2013, 4/2014, 1/2015), WB (2014, 2015)

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The global economic growth shifted to a "new normal" stage

- Growth rate of the world economy was 3.3% (IMF, 2015), slightly higher than that of 2012 and 2013 but remarkably lower than earlier forecasts by international institutions
- **Reasons for low growth rate**:

- Growth rates were uneven among major economies. The US economy grew faster but could not offset the slower growth in China and Brazil; prolonged low growth in Europe and Japan.

- Reduced global trade and investment.

- There were several incidents, such as Ebola epidemic outbreak in Africa and the sharp decline in oil prices starting mid-2014, in line with geo-political tensions such as escalated political tension between Russia, Ukraine and the West, the territorial disputes on the East Sea and the fight against IS in the Middle East.

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The global economic growth shifted to a "new normal" stage

- In the US, after a decline of 2.1% in the first quarter due to the severe consequences of a harsh winter, the US economy gained a spectacular growth in the 2nd and 3rd quarter, respectively reached 4.2% and 3.5%, leading to the economic growth rate of 2.4% in 2014. The improvement in labor market enabled consumption and strengthened consumer confidence and business indices.
- EU: the recession and deflation ware over but growth remained weak and the decline in oil prices in the second half of 2014 brought back the threat of deflation in Europe.
- The policies adopted in EU over the past 5 years since the debt crisis proved to be ineffective. The geopolitical tensions between Russia and the West leading to an economic sanction also contributed to the low growth.

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The global economic growth shifted to a "new normal" stage

- Japan: the consumption tax hike from 5% to 8% coming into effect on Apr 1st, 2014 pushed the Japanese economy from a strong growth in the first quarter of 2014 to a recession in the two following quarters, resulting in the Japanese economy growth of nearly 0%.
- China: growth continued to decline from 7.7% in 2013 to 7.4% in 2014, its lowest level since 2009. China started to reform in recent years, towards transforming the economy from exports-based to domestic consumption-based.
- ASEAN: economic growth continued to fall for the second year in a row, reaching at 4.6% in 2014. Thailand had the lowest growth of 0.7%. Thailand's prolonged political crisis continued to impact negatively on its domestic demand and consumer confidence.

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The global unemployment remained high

- Given the low rate of the world economy, the aggregate demand of the key economies remained weak and the austerity policy in the eurozone continued to make labor markets bleak. The global unemployment was 201.3 million, 1.2 million higher than in 2013 (ILO, 2015).

Table 1.2. The world labor market, 2010-2014

	2010	2011	2012	2013	2014
Labor participate rate (%)	63.4	63.4	63.4	63.5	65.3
Employment growth (%)	1.2	1.4	1.4	1.3	-
Unemployment rate (%)					
Global unemployment	6.1	6.0	6.0	6.0	5.9
Youth unemployment rate	12.9	12.8	12.9	13	13
Unemployment (mil. pers.)					
Global unemployment	196.63	195.45	197.6	200.13	201.3
Youth unemployment	75.44	74.13	74	73.74	73.67

Source: ILO (2015)

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The global unemployment remained high

- Number of unemployed youth fell slightly from 73.74 million (in 2013) to 73.67 million people (in 2014) and equivalent to 13%, nearly three times the rate of adult labor. Youth unemployment continued to create pressure on human resources in the medium term in developed economies.
- Notably, youth unemployment has remained high since the crisis although there have been efforts to improve level of education for the young labor force. This is an alarming situation because if the cyclical unemployment continued to prolong, which might cause a gradual loss of skills and contribute to structural unemployment.

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The global unemployment remained high

- Unemployment rate in EU reduced slightly but remained at the high level of 11.4%. Greece had the highest unemployment rate of 26.4%
- Unemployment rate in the US declined to 6.2%. Employment grew dramatically in services, drinks, retails, restaurants, health care and construction, reflecting the growth of services sector.

Table 1.3. Unemployment in several countries and OECD, 2012-2014 (%)

	2012	2013	2014	2015*
OECD	8	7.8	7.3	7
US	8.1	7.5	6.2	5.6
EU	11.3	12	11.4	11.1
France	-	10.4	10.9	10
Germany	-	5.3	5	4.7
Italia	-	12.2	12.5	12.6
Japan	4.3	4	3.6	3.5

Source: OECD (2015), ILO(2015)

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Global trade remained sluggish

- Global trade growth declined slightly 2014 to 3.4%.
- Reasons: i) weak aggregate demand from the major economies; ii) the fall of oil prices and commodities; iii) rising trade barriers in G20 countries; iv) the decreasingly segmented production network of global value chains led to a decrease in global trade and reduced the trade elasticity to incomes; and v) retaliating economic sanction between Russia, the West and the US.

Table 1.4. Global trade growth in goods and services, 2011-2014 (%)

	2011	2012	2013	2014	2015*
Global trade volume	6.2	2.8	3.5	3.4	3.7
Exports					
Developed economies	6.3	2	3.1	3.3	3.2
Emerging economies	7.4	4.4	4.6	3.4	5.3
Imports					
Developed economies	5.5	0.9	2.1	3.3	3.3
Emerging economies	9.8	6	5.5	3.7	3.5

Source: IMF (2014)

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Global trade remained sluggish

- The appreciation of the USD in 2014 contributed to the increased US trade deficit. Germany replaced China to have the biggest trade surplus, which reached 7.5% of GDP in 2014.
- Although the US deficit increased slightly, the world current account gap did not change due to a decline in the surplus in a number of economies having large surplus such as China, Japan and oil-exporting countries.

Table 1.5. Balance of current account, 2011-2014

	2011	2012	2013	2014	2015*
% GDP					
World	0.5	0.5	0.5	0.5	0.4
US	-2.9	-2.7	-2.3	-2.4	-2.3
Japan	2	1	0.7	0.5	1.9
EU	0.8	2	2.9	2.3	3.3
Germany	6.1	7.1	6.7	7.5	8.4
China	1.9	2.3	2.1	2	3.2
Oil-exporting countries	11.5	10.4	7.4	6.5	-1
$ billion					
World	371	342	374.5	366.9	300.2
US	-458	-440	-379	-400.3	-410.2
Japan	119	60	33.6	24.3	81.6
EU	109	246	284.3	313	388.3
Germany	228.1	252.3	251.3	287.5	286.8
China	136	215.4	182.8	209.8	356.3
Oil-exporting countries	636	608	445	332	-9.5

Source: IMF (2015)

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Trade negotiations could not conclude

- Trade negotiations continued in 2014, which include the Regional Comprehensive Economic Partnership (RCEP), the Trans-Pacific Partnership (TPP) and Trade Partnership Agreements and Investment transatlantic (TTIP).

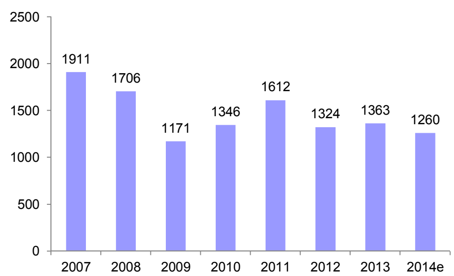
  + TPP aims to utilize and make the most of the US's advantages. This agreement promotes further economic liberalization, which includes provisions on the protection of workers, public enterprise reform, environmental standards, strict protection of intellectual property rights, elimination of tariffs, without any exclusion for sensitive sectors.

  + RCEP becomes more attractive for a number of developing economies because RCEP allows different levels of development with more flexible treatment.

Global capital flows reduced slightly

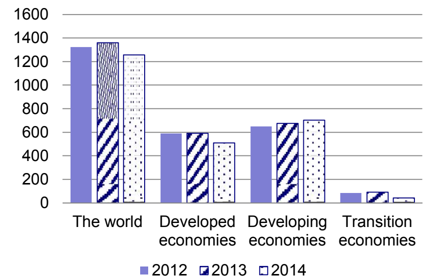
- As the world economic growth remained modest and fragile, the conflicts and geopolitical instability prevented the flow of foreign investment, especially from the developed countries. It mitigated the flow of global FDI by about 8% to $1.26 trillion.
- FDI to the developed countries reduced by 14% to about $511 billion, especially the capital flows to the US declined to $86 billion, about a third of that in 2013.

The global FDI, 2007-2014



Source: UNCTAD, 2015

FDI in groups, 2012-2014

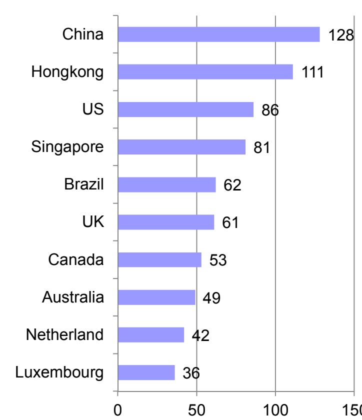


Source: UNCTAD, 2015

Global capital flow reduced slightly

- In developing countries, inflow of FDI made a new record with more than $700 billion, about 4% rise compared to 2013, and accounted for 56% of global FDI inflows. With capital flows into both the financial and non-financial sectors reaching about $128 billion, China became the largest FDI recipient in the world.
- Transnational M&A continued to recover, increasing by 19% to $384 billion, most of which occurred in the financial sector, pharmaceuticals and telecommunications. In 2014, numerous large deals were made. There were 222 M&A deals worth over $ 1 billion, up 32% compared to 2013.
- The TNCs gradually regained confidence and expanded investment, which increased the value of new deals by about 3% in 2014.

Top 10 FDI recipients in 2014



Source: UNCTAD, 2015.

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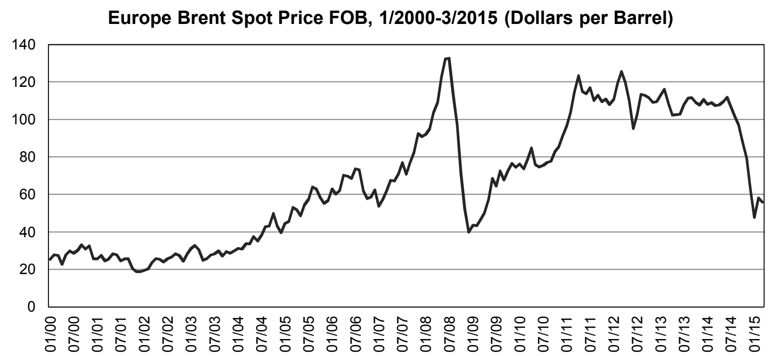
Strong fall in oil prices

- Due political factor between Russia, the US and Western Europe as well as by increased competition for market share, oil supply faced a serious imbalance which made oil prices fall continuously from $111.8/barrel in mid-June 2014 to $47.76/barrel in January 2015.



Source: IEA

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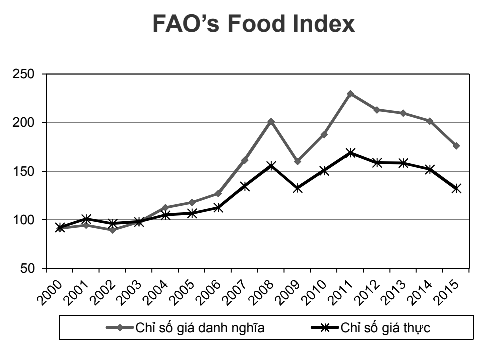
Decline in commodity prices

- Commodity prices simultaneously fell in 2014. Commodity prices have fallen by 28% in 2014, in which energy prices decreased by 38%. Prices of non-energy commodities dropped. Metal prices fell by 15% and prices of agricultural products declined by 6%.
- Food prices also decreased 7% in 9/2014, with an exception of fish.



Source: FAO 2015

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Continued loose monetary policy

- As inflation fell below the 2% target in most major economies, the central banks decided to maintain low interest rates in 2014. The Federal Reserve has decided to end QE3 in May 10th, 2014 and maintained the interest rate at 0-0.25%. The Fed may raise the base rate in 2015
- The European Central Bank had to lower deposit rates to negative 0.2% from May 6th, 2014 to redirect the flow of loans to businesses and consumers, and also lowered the refinancing rate to 0.05% in order to encourage companies to borrow, expand and create more jobs in Europe.
- The Bank of Japan kept the interest rate under 0.1% which was applied since 2009. On Oct 30th, 2014, the BoJ announced an additional annual injection of 30 trillion Yen to the economy through the expansion of its quantitative easing programme. The supply of money was raised to 80 trillion Yen/year.
- People's Bank of China pumped 769.5 billion yuan ($126 billion) into the banking system to refinance banks. In November 2014, PBoC cut the base rate for the first time in over two years to support the economy. The benchmark lending interest rate was reduced from 6% to 5.6% and the interest rate of 1-year deposit also was cut from 3% to 2.75%.

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Flexible fiscal policies

- Global budget deficit increased slightly in 2014 compared to 2013 and reached 3.3% of GDP.
- The fiscal situation improved in the US as the deficit fell to $483.3 billion (equivalent to 5.3% of GDP), down sharply from $680.2 billion in 2013.
- Japan: increased revenues from consumption tax contributed approximately $48 billion to the budget to help reduce the budget deficit to 7.7% of GDP, although this remained the highest level among developed countries.

Table 1.6. Budget deficit in several economies, 2009–2014 (% of GDP)

	2009	2010	2011	2012	2013	2014
World	-7.3	-5.9	-4.3	-3.9	-3.2	-3.3
Europe	-6.2	-6.1	-4.1	-3.6	-2.9	-2.7
France	-7.2	-6.8	-5.1	-4.9	-4.1	-4.2
Spain	–11.1	–9.4	–9.4	–10.3	–6.8	-5.8
Germany	-3.1	-4	-0.8	-0.1	0.0	0.6
Italia	–5.4	–4.4	–3.7	–2.9	–3.0	–3.0
Greece	-15.6	-10.8	-9.6	-6.3	-2.8	-2.7
Russia	-5.5	-3	1.6	0.2	-1.5	0
UK	-11.3	-10.0	-7.8	-8.0	-5.8	-5.7
Japan	-10.4	-9.3	-9.8	-8.7	-8.4	-7.7
US	-13.5	-11.3	-9.9	-8.6	-5.8	-5.3
China	-1.8	-1.2	0.6	0	-1.1	-1.1
India	-9.8	-8.4	-8.1	-7.5	-7.2	-7.1

Source: IMF Fiscal Monitor (4/2015)

Flexible fiscal policies

- Japan deferred the 2nd phase of consumption tax hike (from 8% to 10%) to May 4th 2017 as the economy could not stand the shock from the first phase of consumption tax increase.
- US: income tax is expected to increase to a maximum of 28% for high-income families
- EU: budget deficit is contained at below 3% of GDP, but the European sovereign debt continued to increase during the last six years and reached 94% of GDP in 2014. France, Spain, and Italy still had high budget deficit and failed to meet the provisions of the EU.

Table 1.7. Government debt in several countries, 2009–2014 (% GDP)

	2009	2010	2011	2012	2013	2014
World	75.4	77.7	78.7	80.5	79.1	79.8
Europe	78.4	83.9	86.5	91.1	93.4	94
France	78.8	81.5	85	89.2	92.4	95.1
Spain	52.7	60.1	69.2	84.4	92.1	97.7
Germany	72.4	80.3	77.6	79.0	76.9	73.1
Italia	112.5	115.3	116.4	123.2	128.6	132.1
Greece	126.2	145.7	171	156.5	174.9	177.2
Russia	10.6	11.3	11.6	12.7	14	17.9
UK	65.8	76.4	81.8	85.8	87.3	89.5
Japan	210.2	216	229.8	236.8	242.6	246.4
US	86.1	94.8	99.0	102.4	103.4	104.8
China	35.8	36.6	36.5	37.3	39.4	41.1
India	72.5	67.5	68.1	67.5	65.5	65

Source: IMF Fiscal Monitor (4/2015)

Flexible fiscal policies

- EU: a number of countries have made fiscal adjustments to overcome the current debt crisis.

  - France: Increased corporate income tax on February 2014 by about 5% to 10.7% from the current level and expected to be in effect in two years (the European Commission (2014).

  - Italy: cut public spending and reduced taxes for low-income people through a package of tax cuts for 10 million low-income people from 8000-26000 Euro/year. VAT increased in food and beverage dispensing machines sold at vending from 4% to 10%.

  - Spain: postponed salary increases in the public sector and reduces spending in education and health.

  - Greece: personal income tax are adjusted from Jan 1st, 2014, the income of farmers is treated as the income of the household business and taxed at a fixed rate of 13%, without being exempted for income under 5000 Euro as before.

VEPR Prospects for 2015 and beyond

- In 2015, the world economic growth is expected to slightly increase compared to 2014, with the expectations of the US, Germany and the UK economies being the main drivers of growth. Underneath the economic recovery, there exist mixed trends affecting global growth.
- China will continue to experience a slow-down in growth during its reform path.
- The Russian economy will continue to suffer the sanctions imposed by the West related to the crisis in Ukraine as well as the impact of lower oil prices and the capital flight.
- The enhanced quantitative easing will cause the Yen continue to depreciate in 2015, facilitating the exports of Japan. The economy of EU and Japan are expected to grow, albeit slowly.
- The US plans to increase the base rate in June 2015. This trend is likely to cause volatility on exchange markets and the world financial markets, and impact on countries with foreign debt denominated by USD.

VEPR Prospects for 2015 and beyond

- The world trade will remain bleak due to weak aggregate demand. The RCEP and TPP negotiations are expected to be concluded in 2015. The AEC will be established by the end of 2015 with an expectation of facilitating greater intra-ASEAN trade and investment.
- Although the US oil production has decreased significantly but oil supplies worldwide are growing faster than demand. On the other hand, due to the pressure on geopolitical issues, oil prices in 2015 will not decrease but unlikely to rise sharply. Food prices may fall due to further improvement of supply of the main food products. Price of cereals and major vegetable are expected to drop sharply, especially for wheat and soybeans due to lower fuel costs and an improvement in agricultural production.
- Global FDI flows will also have many obstacles including weak aggregate demand and fragile growth, falling commodity prices, weak trade. Global FDI may decline slightly in 2015 (UNCTAD, 2015).

Prospects for 2015 and beyond

- There is not many positive signs in international trade, global capital flows as well as mixed trend in potential growth, the global economy in 2015 is forecasted at moderate, around 3.5% according to the IMF forecast (2015) and 3% of the World Bank (2015).

Table 1.8. Forecast of the world economic growth 2015

% GDP	IMF	WB	UN	ADB
World	3.5	3.0	3.1	n.a
Developed economies	2.4	2.2	2.1	n.a
US	3.1	3.2	2.8	3.2
Japan	1.0	1.2	1.2	1.1
Europe	1.5	1.1	1.3	1.1
Emerging economies	4.3	4.8	4.8	n.a
China	6.8	7.1	7.0	7.2
India	7.5	6.4	5.9	7.8
ASEAN-5	5.2	n.a	n.a	n.a
Russia	-3.8	-2.9	0.2	n.a
Brazil	-1.0	1.0	1.5	n.a

Source: IMF, WB, ADB and UN (2015)

Implications to Viet Nam

- First, the US is expected to tighten monetary policy by interest rate instruments in June 2015. That may cause certain pressure on the exchange rates for many countries, including Vietnam where a stronger dollar would require the exchange rate policy to be more flexible. For foreign debt, if the US dollar appreciate sharply in the coming period, the dollar-debt may have to bear a higher cost.
- China's growth slowed in a more sustainable way which will help it maintain inflation at a low level so the countries depending on exports from China, such as Viet Nam will also benefit from low costs. However, the quality of products imported from China should be subject to tighter control.

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Implications to Viet Nam

- The oil price in the future will gradually increase slightly due to world supply which has narrowed following the peak seen in early 2014. With this trend, the transportation from individuals and households to businesses will no longer benefit from the reduction in oil price seen in 2014. As both a producer and consumer of gasoline, so Viet Nam's state budget revenues from the export of crude oil will be improved. But as the price of petroleum products will tend to rise, the rising cost of production could cause pressure on the consumer price index in 2015.
- As economic forecasts for the US, Europe and Japan, the largest trade partners of Viet Nam, will be more optimistic in 2015, the coming year may be more favorable for the export of goods from Viet Nam. However, Viet Nam's enterprises still need to continue to improve the quality of their products to meet the demand in these strict markets with their system of technical barriers to trade.

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Implications to Viet Nam

- Global M & A will continue to grow especially in the financial sector and made by TNCs of the group of developed economies and emerging economies. Vietnam needs to continue to improve the investment environment to become more competitive in embracing this trend.
- As the growth of the global economy in next stage depends on the applicability and commercialization of scientific and technological achievements, Vietnam should change the traditional growth model, further effectively exploit the growth model based on comparative advantage, and create a foundation for transition to a new growth model, based on economies of scale, technology and innovation.
- Global economic growth is still based on the promotion of trade liberalization. Therefore, Vietnam continues to deeper integration into the global economy, creating external pressure to reform inside and get more favorable conditions as call for the resources to serve development goals.

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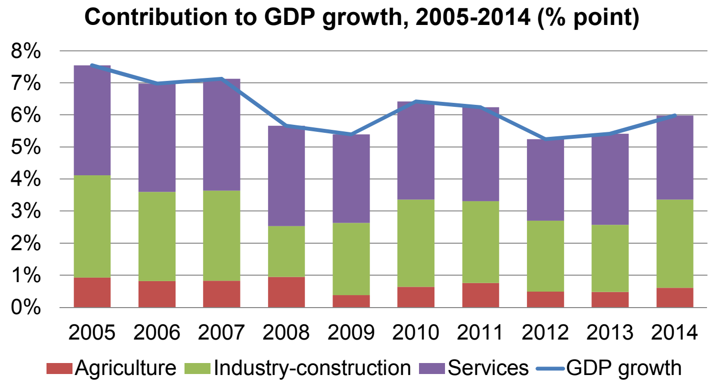
Chapter 2:
Overview of the Vietnamese economy

Ngo Quoc Thai
Nguyen Thi Thu Hang

VEPR Contents

Higher economic growth

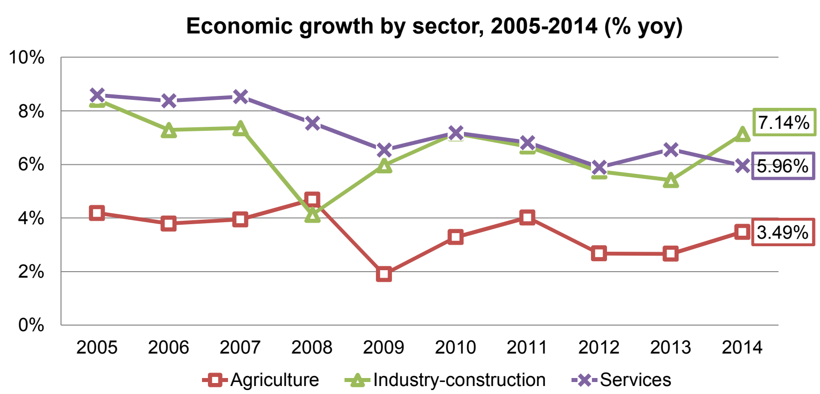
…mainly contributed from industry (7.14%, yoy) and services (5.96%, yoy)
Acceleration in the second half: Q3 growth increased 1 percentage point, Q4 growth increased 2 percentage points compared to same period 2013



Source: GSO

but not in the same direction

...industry speeding up to pre-2008 level, services decelerating to a 10-year low
- Lagged consumption
- Higher growth was mainly stemmed from the foreign factor

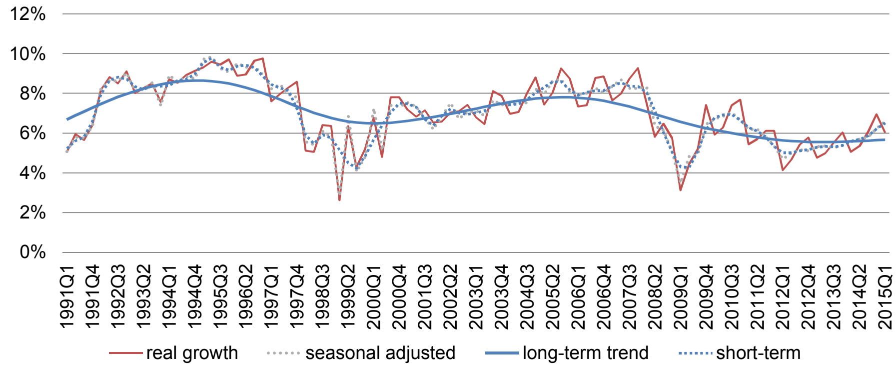


Source: GSO

VEPR and decreasing long-term growth trend

...although short-term growth (seasonally adjusted) exceeding long-term growth
This "boom" tends to reduce unemployment and raise inflation rate

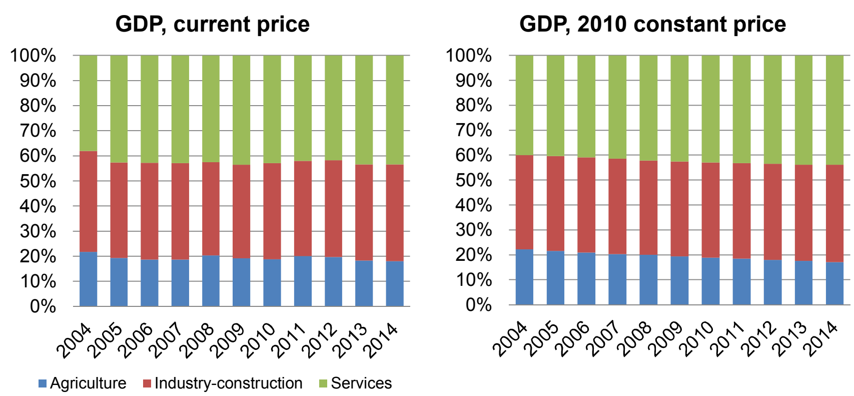
Growth trend of the Vietnamese economy, 1991-2015q1 (% yoy)



Source: calculated from GSO

VEPR Economic structure barely changed

...because of minor difference in productivity and growth between sectors

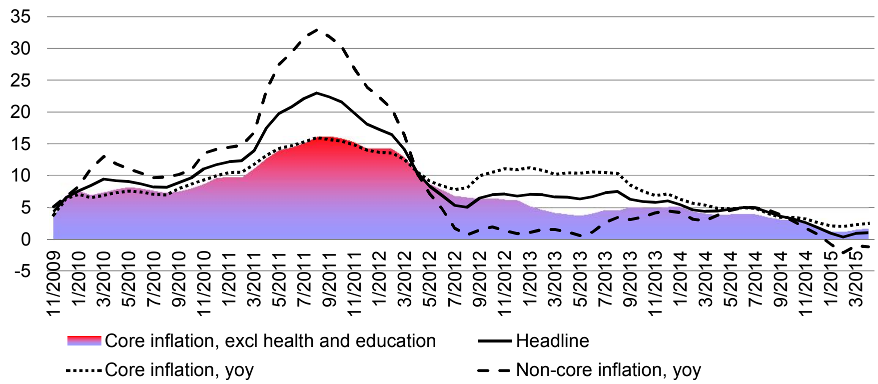


Source: GSO

VEPR Inflation rate declined

Global commodity prices (food, foodstuff, gasoline) dropped
Public services fees (education and health) rose by a lower rate
Constrained household consumption

Inflation rate, 2009-2015 (%, yoy)

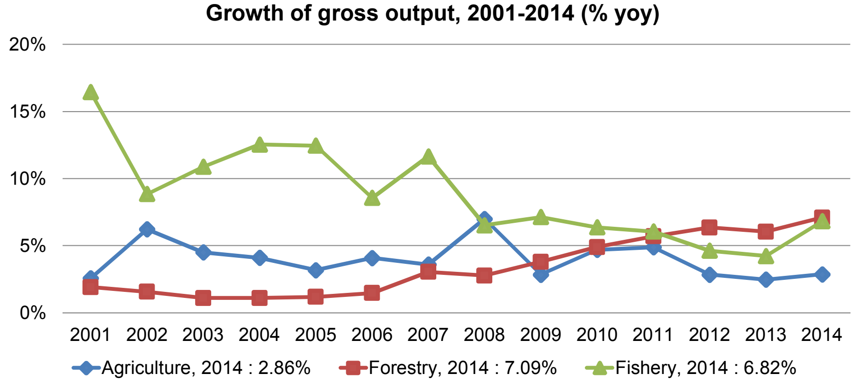


Source: calculated from GSO

VEPR Aggregate supply Agriculture, forestry and fishery

Sluggish agriculture, growth of forestry and fishery picked up (~7%)

Growth of gross output, 2001-2014 (% yoy)



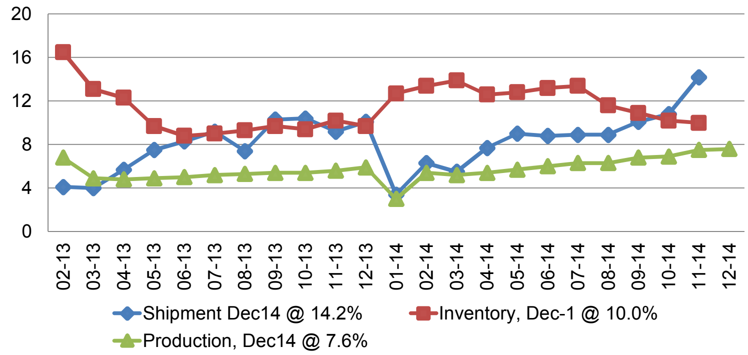
Source: GSO

VEPR

Industrial sector recovered

Processing manufacturing accelerated during the second half
Industrial production index rose by 7.6% yoy compared to 5.9% of 2013

Industrial sector indices, 2013-2014 % yoy



Source: MoIT

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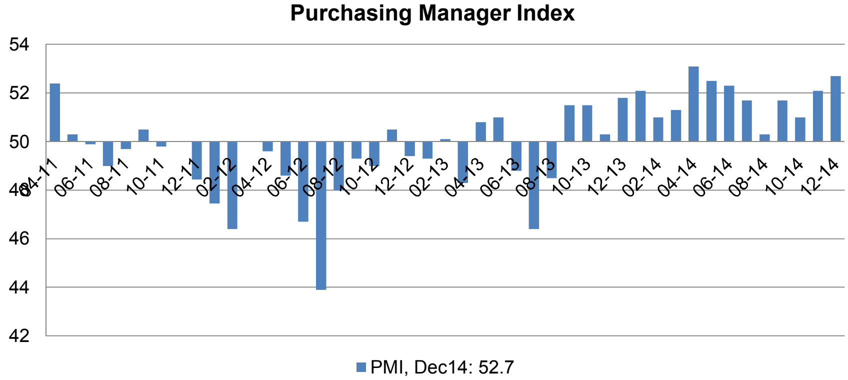
Better production conditions

PMI > 50 for 16 months since 9/2013
Output, new orders, and employment improved
Higher demand from both domestic and foreign markets

Purchasing Manager Index



Source: HSBC-Markit

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but not all firms could materialize

- The number of firms halting operation and dissolved reached the peak in 4 years (2011-14), of which over-3-year-old firms were the majority.
- Small and micro firms accounted for a major percentage
- Continuous losses, unable to access to capital
- Inventory rose, albeit slowing during the second half
- Restrained consumption

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Services slowed down, while imports increased

- Growth at a 10-year low
- Services imports 14.5 USD, + 22% yoy
- While exports only 11 billion USD, +4% yoy
- Imports rose the most in logistic and marine insurance

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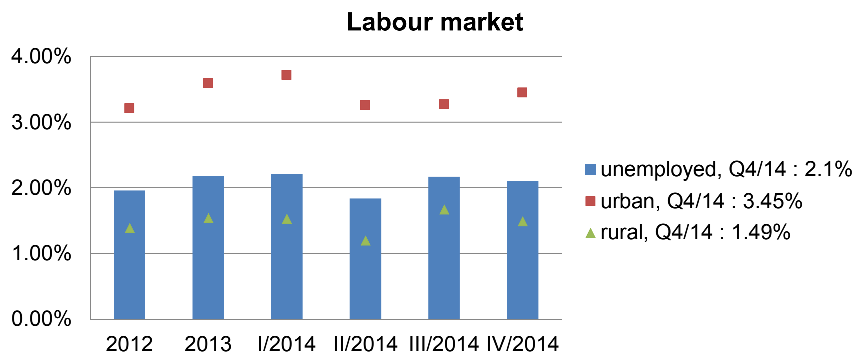
Low overall unemployment rate, high youth unemployment rate

40% of the unemployed are of age between 15-24*
Proportion of employed youth fell due to aging population



Source: GSO

* Of working age, without job for 7 days, seeking job

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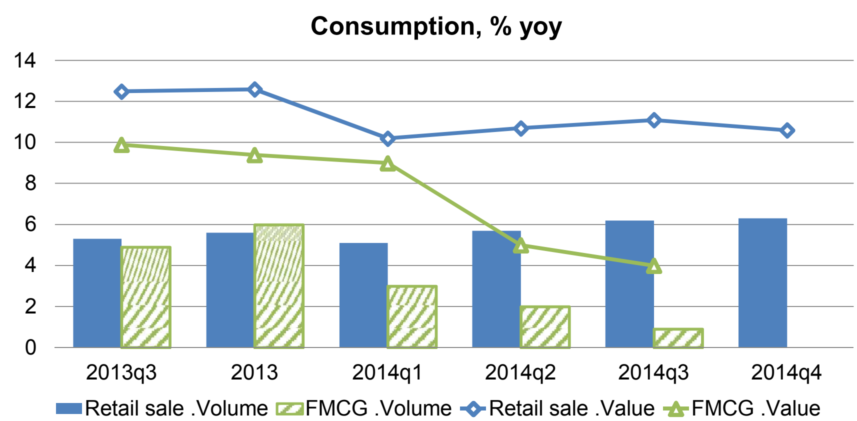
Aggregate Demand Consumption signals are mixed

GSO: sale of goods and services improved
Kantar: Fast-moving consumption goods have been falling



Source: GSO, Kantar Worldpanel

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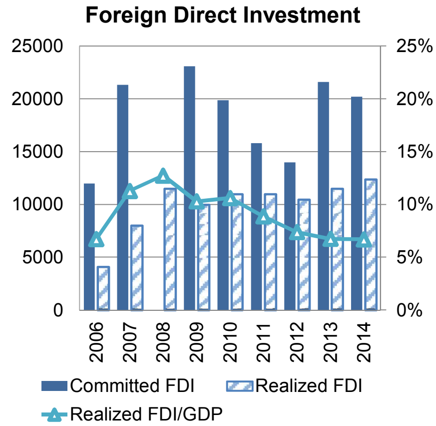
FDI lead investment

- Decreasing ratio to GDP
- Most of new FDI goes to manufacturing (72%)
- Violent riot in May contributed to the fall in committed FDI

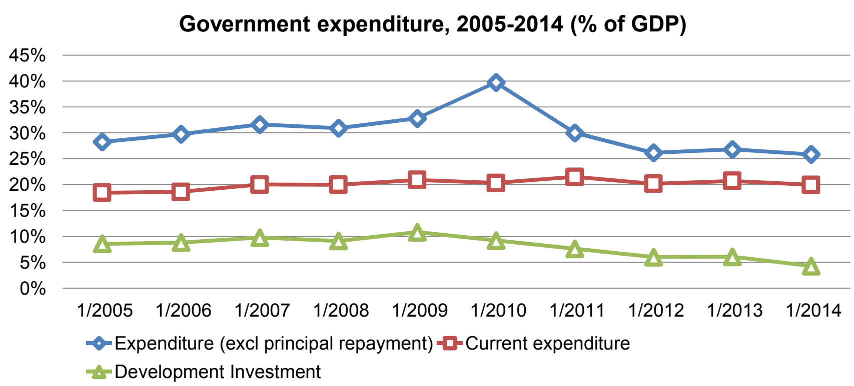


Source: GSO

VEPR

Buget cut investment to pay salary and repay loans

No clear progress in reducing public pay rolls
Loan repayment rose 14%, interest surpass principles
Development investment dropped by 22% yoy



Source: CEIC Database

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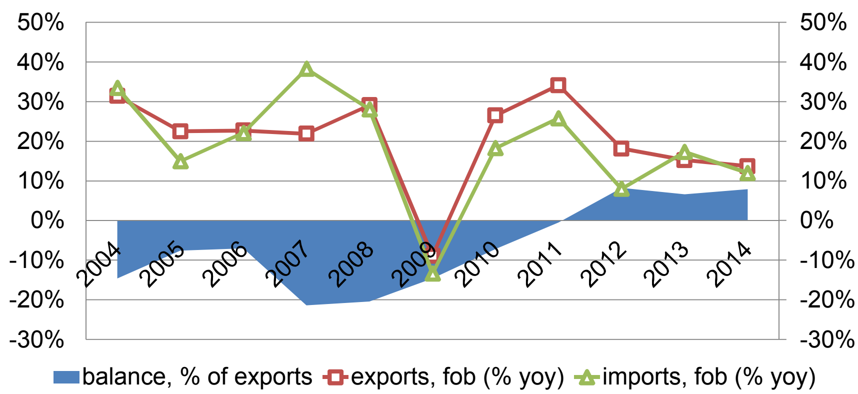
Surplus trade in goods

Growth led by foreign-invested sector: mobile phone, computer, textiles
Large deficit to China, ASEAN, increasing deficit with Korea (Samsung, LG)



Source: SBV

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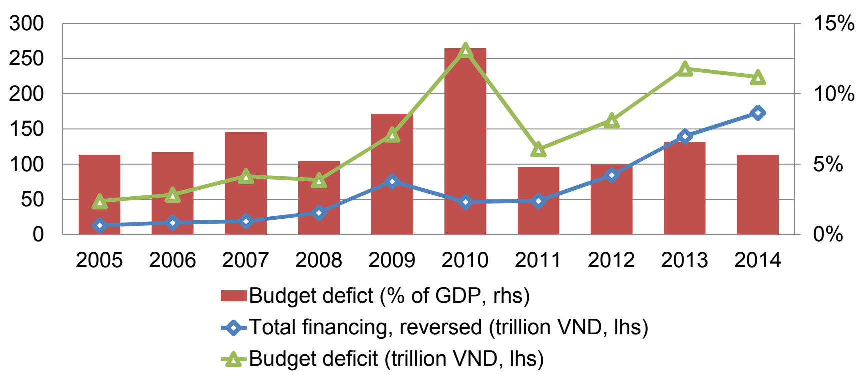
Budget deficit

Revenue rose by 3% while expenditure rose by 6%
Cutting development investment
Deficit accounted for 5.7% GDP, total financing ~ 173 trillion VND

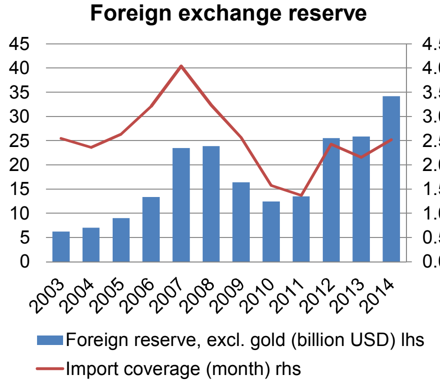


*Deficit = (Expenditure + Principle payment) – Revenue
Total financing = Transactions in financial assets minus transactions in liabilities

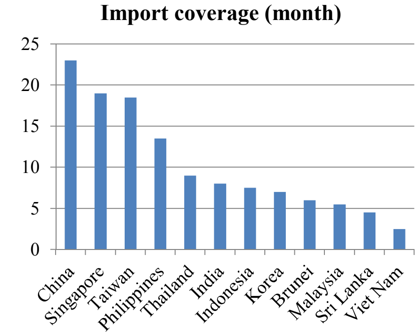
Source: CEIC Database

VEPR Improved balance of payments

FDI is the main source of BoP surplus
Remittance was almost offset by payment of investment income
Foreign exchange reserve below required level, lower than neighbouring countries - Less open capital market



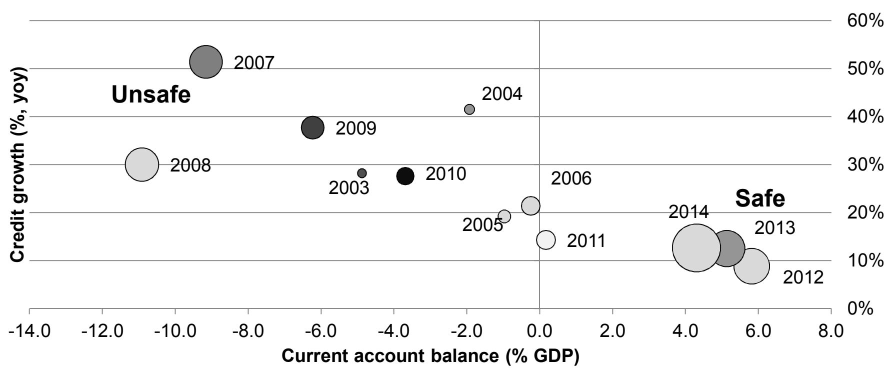
Source: UN, SBV



Source: HSBC

VEPR Improved overall balance

The economy cooled down, falling investment (% of GDP)
Since 2011, rebalanced between growth and macro stability
More growth oriented



Source: calculated from UN, SBV, CEIC

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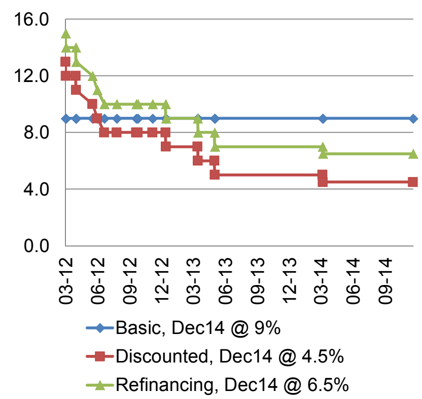
Interest rate cut

- Operating rate cut by 50 basis points in March
- Prudent in remaining months because of concern about inflation



Source: SBV

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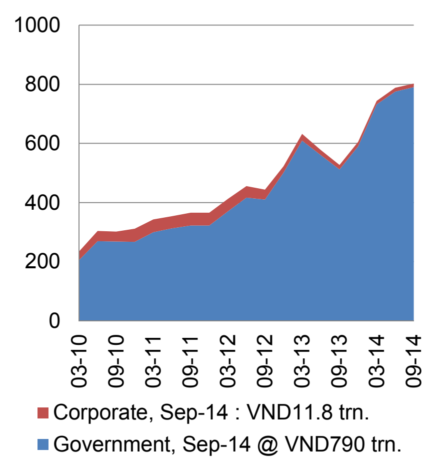
SOE privatization returned, bond market rallied

- SOEs privatization returned but none of 40 stocks being trade in the secondary market; foreign investors avoid buying shares due to the lack of liquidity and high State ownership
- Bond issued 237 trillion VND
- Long maturity bond + foreign currency bond
- Corporate bonds: 26.7 trillion VND, ~ 10% of total bonds issued



Source: ADB

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Banks underwent restructuring

- Focus on core activities
- No merger or acquisition
- Improved financial capacity (contracted net interest margin)
- Bank of Construction failed
- Non-performing loans may have decreased but still be unsound (>>3%)
- Uncertainty about actual financial soundness
- SMEs difficult to access loans
- NPLs disposal faced obstacles in resolving collaterals attached to land

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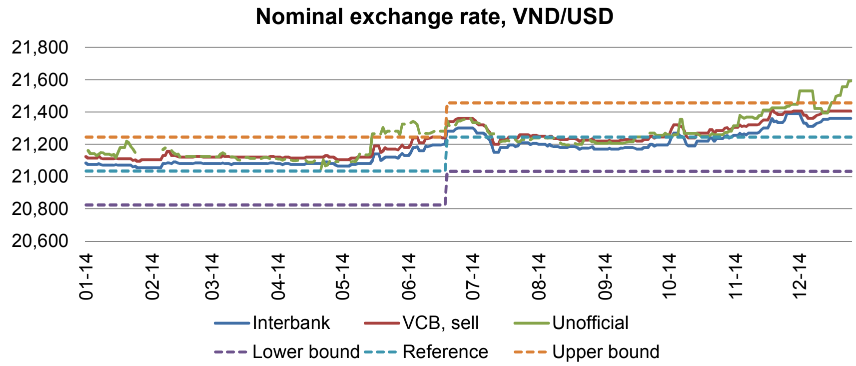
Expansion of foreign currency credit - an exception of the State Bank

- Outstanding credit rose by 14%
- Foreign currency credit rose 2 to 3-fold compared to domestic currency
- Lower interest rate and low risk of exchange rate
- Dollarization rose
- Loan/Deposit in forex 88%, VND 80%
- Could pressurize the balance of the money market

VEPR Rising exchange rate

Soft peg to USD: exchange rate band + interference
Forex reserve + Low macro risks
→State Bank controlled the depreciation of VND
← VND appreciation in real terms, affecting competitiveness of exported goods



Source: SBV, VCB

VEPR Stock indices fluctuated

Influenced by

- China invaded Viet Nam's SEZ in the East Sea
- Plummeting oil price since September
- Margin trading

Source: BSC

VEPR Policy implications

- As economic growth is constrained partly by institutional factors, institutional reforms and setting up sound macro environment remain highest priority in coming period.
- Risks and macroeconomic imbalances can accumulate in the high-growth phase but can be easily overlooked. High growth is unsustainable due to the economic cycle and sticky structure.
- Because benefits from lower oil prices will only be realized more clearly in the medium term, the government would be more tempted to raise taxes or create inflation. Negative impacts created by increased taxes or inflation could damage outlook and slow down economic recovery.

VEPR Policy implications

- The SBV should be prudent with foreign currency-denominated credit. Promoting foreign currency-denominated credit can ease the burden of the banking system in terms of credit growth, yet it seems to conflict with the goal of reducing the rate of dollarization in the Vietnamese financial system.
- Remittances are masking the deficit in trade that tends to depreciate the VND.
- The expected impact of the appreciation of real exchange rate on the Vietnamese exported goods urges the reconsideration of exchange rate policy. The narrow adjustments as seen in the past three years are considered too cautious and weakening domestic firms.

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Chapter 3:
The instability behind the stability of the nominal exchange rate

Pham Van Dai
Nguyen Duc Thanh
Nguyen Thanh Tung

VEPR Exchange rate policy: Overview

- The collapse of the Bretton Woods system in 1970s => governments have been more active in exchange rate management.
- Most countries attempt to obtain an appropriate exchange rate rather than leaving it to the market force.
- However, there was a series of currency crises: East Asia (1997-98), Russia (1997-99), Mexico (1995), Argentina (1998-2000).

=> To determine an appropriate level of exchange rate is not an easy question.

VEPR Viewpoints on exchange rate policy

- Washington consensus (WB, IMF): exchange rate should be at equilibrium level, avoiding undervaluation and overvaluation.
- Mercantilist: undervaluation to support exports and economic growth
  - ✓ Positive: China
  - ✓ Negative: High inflation in Latin America

⇒ Unanimous: Avoiding overvaluation

Under debate: an equilibrium or undervalued exchange rate

VEPR Viet Nam's circumstance

- Small international reserve
- High openness
- Exchange rate instability + less financial development => high inflation and low efficiency of the economy.
- A less developed welfare system => vulnerable low-income classes

=> Importance of the exchange rate issue

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Estimating equilibirum exchange rate for Viet Nam

- Purchasing power parity (PPP) approach:
  - ✓ Real effective exchange rate(REER) and bilateral real exchange rate (RER)
  - ✓ Advantages: simple
  - ✓ Disadvantages: The equilibrium level of exchange rate is constant => not realistic

⇒ An effective tool to discuss the short-run movement of the exchange rate, but not appropriate for long-term analysis.

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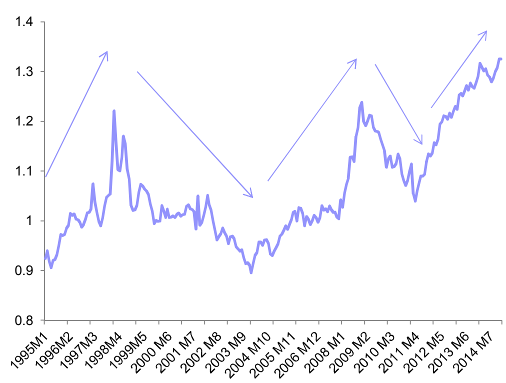
REER in Viet Nam

- ✓ Before the East Asian Crisis 1997: appreciation
- ✓ Post-crisis: depreciation
- ✓ Joining WTO to the global crisis 2008: appreciation due to inflow capital
- ✓ 2008-2011: depreciation due to tightening policies
- ✓ 2011-currently: appreciation

REER in Viet Nam, 1995-2014 (2000 = 100%)



Source: VEPR's calculation

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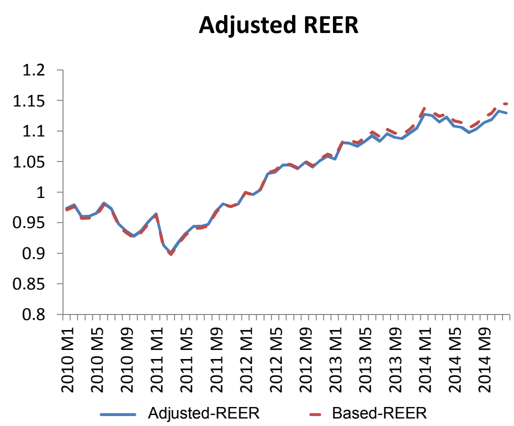
REER in Viet Nam

- REER increases from 2011 to currently despite :
  - ✓ Controlled inflation
  - ✓ Favorable international conditions: USD goes down due to QE program; CNY appreciates.

⇒ Reason: slow pace of nominal devaluation of (2-3% annually)

- 2012 as the base year:
  - ✓ REER is 14.5% overvalued
  - ✓ After adjusting for unofficial trading volume with China, REER is 13% overvalued



Source: Authors' calculation

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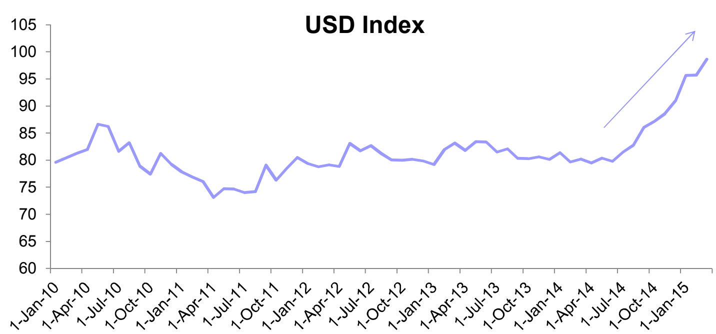
REER in Viet Nam

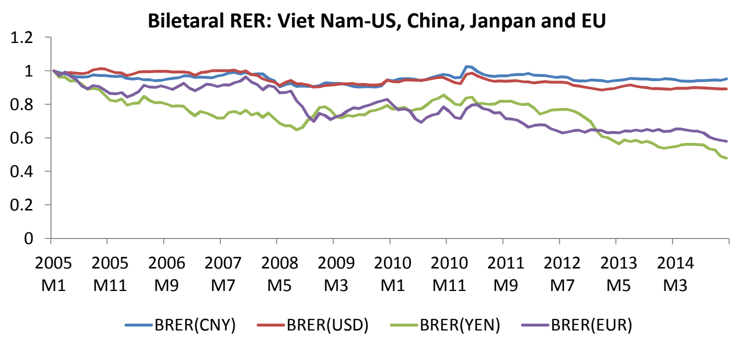
- REER has rapidly increased since QIII/2014 because of the end of QE program. USD recovers => an USD-pegged exchange rate is seriously affected.



Souce: Bloomberg

Biletaral real exchange rate Vietnam-US, China, Janpan and EU

- Biletaral RER with major trading partners
  - ✓ US and China: Fairly stable
  - ✓ Japan and EU: Unfavorabe to exporters



Source: Authors' calculation

Good Policy, Sound Economy

Estimating equilibrium exchange rate for Vietnam

- General equilibrium approach
  - ✓ Simulating an general equilibrium model or estimating a reduced equation.
  - ✓ Advantages: a comprehensive theoretical framework.
  - ✓ Disadvantages: Complication and there is no unique empirical framework.

=> The best tool to calculate equilibrium exchange rate in developing countries

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Estimation results

	Viet Nam		China		Thailand		Malaysia		Phillipines		Indonesia	
	MIS1	MIS2	MIS1	MIS2	MIS1	MIS2	MIS1	MIS2	MIS1	MIS2	MIS1	MIS2
1996	*0.87*	*0.79*	0.82	0.86	1.06	1.23	1.08	1.02	1.09	1.20	1.07	0.86
1997	*0.92*	*0.84*	0.91	0.92	1.00	1.21	1.05	0.99	1.11	1.22	1.00	0.81
1998	*1.08*	*0.93*	1.10	1.05	1.00	1.26	1.03	0.98	1.04	1.10	0.70	0.60
1999	*1.11*	*1.01*	0.98	0.93	0.99	1.17	1.00	1.00	1.10	1.20	0.83	0.67
2000	*1.05*	*1.02*	1.04	0.98	0.99	1.09	1.01	1.00	1.04	1.08	0.86	0.81
2001	*1.02*	*1.01*	1.08	1.02	0.94	1.06	1.12	1.12	1.01	0.99	0.81	0.77
2002	*0.98*	*0.98*	1.05	0.99	0.98	1.11	1.06	1.02	0.99	1.00	0.95	0.89
2003	*1.00*	*1.04*	1.04	0.99	0.97	1.07	1.04	1.04	0.90	0.92	1.04	0.95
2004	*1.01*	*1.07*	1.04	0.98	0.98	1.06	1.07	1.03	0.89	0.94	1.01	0.93
2005	*1.05*	*1.08*	1.01	0.96	0.97	1.04	1.06	1.06	0.92	0.93	0.99	0.92
2006	*1.01*	*1.03*	0.98	0.95	0.98	1.03	1.00	0.99	0.95	0.99	1.08	1.01
2007	*1.02*	*0.97*	0.95	0.94	1.02	1.10	0.99	0.98	0.98	1.02	1.04	1.00
2008	*1.02*	*0.95*	1.02	1.00	1.03	1.03	0.95	1.02	1.02	1.02	0.98	0.99
2009	*1.05*	*1.05*	1.04	1.00	1.04	1.09	0.95	0.93	0.98	0.96	0.95	0.99
2010	*0.97*	*0.99*	0.98	0.97	1.04	1.04	0.94	0.95	1.01	0.94	1.07	1.13
2011	*0.95*	*0.98*	0.98	0.97	1.07	1.05	0.94	0.94	1.01	0.96	1.07	1.12
2012	*1.03*	*1.09*	1.00	1.01	1.00	0.96	0.93	0.90	1.04	1.01	1.01	1.06
2013	*1.07*	*1.11*	1.01	1.00	1.01	1.03	0.90	0.87	1.07	1.03	0.95	0.98

Source: Authors' calculation

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Estimation results

- Estimation results confirm the appreciation trend of VND from 2011.
- VND is 7-11% overvalued in 2013.
- This is the largest disequilibrium in the area.
- Except Philippines, Viet Nam is the only countries maintaining overvaluation in 2012-2013 in the area.

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Impact of overvaluation on domestic production

- Applying CGE (Computable general equilibrium) model developed by Viet Nam National University, Hanoi.
- Scenarios: Overvaluation (1%, 5%, 10%); Undervaluation (1%, 5%, 10%).
- Six industries are negatively affected by overvaluation: Agriculture, agricultural product processing, labor-intensive light industry, heavy industry, and mining.
- Two industries benefit from overvaluation: capital-intensive manufacturing industry and service.

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Impact of overvaluaion on industries (%)

Scenarios	Undervaluation			Overvaluation		
	1%	***5%***	***10%***	***1%***	***5%***	***10%***
Output						
Agriculture	0.43	2.43	5.58	-0.40	-1.69	-2.63
Mining	0.30	1.58	3.33	-0.29	-1.39	-2.56
Agricultural product processing	0.44	2.48	5.69	-0.41	-1.72	-2.64
Labor-intensive light industry	0.92	4.89	10.51	-0.89	-4.18	-7.65
Heavy industry	0.28	1.45	2.99	-0.28	-1.35	-2.58
Manufacturing industry	-0.86	-4.36	-8.90	0.86	4.25	8.45
Service	-1.14	-5.51	-10.54	1.17	6.07	12.81

Source: Authors' calculation

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Impact of overvaluaion on industries (%)

Scenarios	Undervaluaion			Overvaluation		
	1%	*5%*	*10%*	*1%*	*5%*	*10%*
Imports						
Agriculture	-0.94	-4.21	-7.36	0.99	5.49	12.53
Mining	-1.18	-5.32	-9.32	1.25	6.94	15.90
Agricultural product processing	-1.73	-7.97	-14.46	1.80	9.78	21.83
Labor-intensive light industry	-0.77	-3.48	-6.08	0.81	4.50	10.21
Heave industry	-0.56	-2.62	-4.82	0.58	3.10	6.79
Manufacturing industry	-2.99	-14.48	-27.90	3.04	15.77	33.17
Service	-2.59	-12.11	-22.35	2.68	14.45	31.86

Source: Authors' calculation

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Impact of overvaluaion on industries (%)

Scenarios	Undervaluaion			Overvaluation		
	1%	*5%*	*10%*	*1%*	*5%*	*10%*
Exports						
Agriculture	1.05	5.54	11.82	-1.02	-4.84	-9.04
Mining	0.67	3.31	6.54	-0.67	-3.40	-6.88
Agricultural product processing	1.15	6.02	12.76	-1.12	-5.32	-9.97
Labor-intensive light industry	1.32	6.89	14.55	-1.29	-6.16	-11.64
Heave industry	0.54	2.72	5.46	-0.54	-2.70	-5.37
Manufacturing industry	-0.33	-1.76	-3.86	0.31	1.45	2.64
Service	-0.22	-1.10	-2.22	0.22	1.09	2.16

Source: Authors' calculation

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Impact of overvaluaion on industries (%)

- Labor-intensive light industry is most affected by overvaluation. 10% overvaluation => output and exports shrink 7.65% and 11.64%.
- Capital-intensive industry benefits because using more imported production input. 10% overvaluation => imports increase 33.07%.
- Overvaluation stimulates consumption. Overvaluation increases output and imports of service.

=> Overvaluation is bad for industries using more domestic production input and good for industries using imported input.

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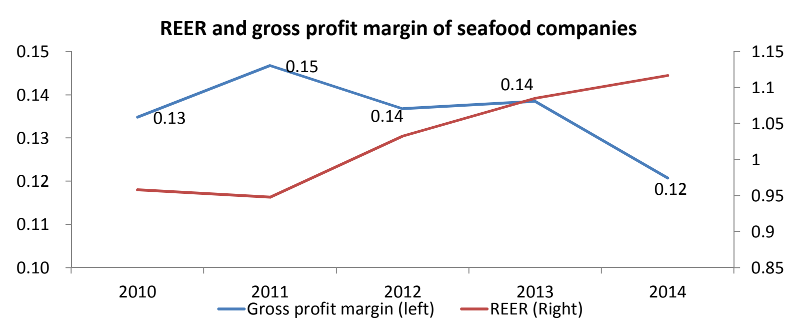
Example: Impact of exchange rate on seafood exporting companies

- Average gross profit margin of listed seafood companies fluctuates according to exchange rate movement. This margin decreases from 15% in 2011 to 12% in 2014.
- Notably, the rate of 12% is low in a production industry which has a low revenue to asset ratio => Seafood companies will suffer much difficulty if VND continues going up.



Source: Authors' calculation

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Conclusion

- VND appreciated over 2011-2014, and is 7-11% overvalued.

⇒ This negatively affects industries employing domestic production input: Agriculture, agricultural product processing, labor-intensive light industry, heavy industry, and mining. These industries have major contribution to job creation and productivity improvement in the economy.

- Sudden decrease in the number of tourist visiting Viet Nam recently, the re-emergence of net imports should be taken into consideration under the impact of current exchange rate policy
- It is necessary to set up a suitable roadmap to realign the Vietnam dong towards the equilibrium exchange rate.
- The adjustment in exchange rate should be greater than the discrepancy between Viet Nam's and the world's inflation.

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Chapter 4:
Macroprudential Analysis for Viet Nam's Banking Sector 2015 – An Application of Stress Testing

Vu Minh Long
Nguyen Duc Thanh

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Main contents

- Introduction on stress testing
- Application of stress testing for Viet Nam's banking sector
- Constructing a stress test for selected Vietnamese banks in 2015
- Conclusion and policy recommendations

Introduction on stress testing

- The term stress testing, as defined in Blaschke, Jones, Majnoni & Peria (2001), Cihak (2004) or Oura and Schumacher (2012), describes a range of techniques used to assess the vulnerability of a portfolio, an institution, or an entire financial system under different hypothetical events or scenarios.
- It is a quantitative "what if" exercise, estimating what would happen to capital, profits, cash flows, etc. of individual financial institutions or the system as a whole if certain risks were to materialize.
- The scenarios must be extreme/exceptional and plausible.

The typology of stress tests

- **By objective**
  - *Microprudential stress testing*: assesses the health of an individual institution, inform supervision of the institution.
  - *Macroprudential stress testing*: identifies risks of the entire system.
- **By approach**
  - *Bottom-up approach*: carried out by individual financial institutions using their own internal data and models, often under common assumptions. Supervisory office then collects results to analyze the whole system.
  - *Top-down approach*: conducted by supervisory authorities (normally central banks), using bank-by-bank data and applying a consistent methodology and assumptions.

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The typology of stress tests

- **By data source**
  - *Balance sheet-based*: more informative but back-ward looking, data intensive, and hard to update given typical lags in the release of the relevant information.
  - *Market price-based*: forward looking and easily updated but hard to be applied in under-developed markets.
- **By number of risk factors**
  - *Sensitivity test*: involves a single risk factor, easy to conduct but impractical as risk factors tend to occur simultaneously.
  - *Scenario analysis*: involves a group of risk factors, requires complicated calculations.

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Components of a stress test

Component	Research questions	Methodology
Coverage	Which institutions are important for the exercise?	Analysis of the feature of the financial system
Identification of risk and vulnerabilities	Which are the weak points of the institutions?	
Shock calibration	Which event can trigger the vulnerabilities?	Historical, hypothetical, reverse engineering approaches
Implementation of the scenario	How is the shock transmitted to the macroeconomy?	Main macro and satellite models
Mapping from macroeconomy to banks' portfolios	How do changing macroeconomic variables affect banks?	*Ad hoc* statistical methodology depending on risk types
Interpreting of results	Is the impact relevant? Are countermeasures available? Should emergency plans be implemented	

Source: Quagliariello (2009)

Application of stress testing for Viet Nam's banking sector

- Legal framework
  - State Bank of Vietnam (SBV) issues only suggestive regulations on internal models to assess capital, assets and liquidity of banks at Article 4, Circular 36/2014/TT-NHNN on 20/11/2014 capital adequacy and liquidity requirements for credit institutions including branches of foreign banks.
- Stress testing by supervisory authorities
  - Conducted internally by SBV or National Financial Supervisory Commission (NFSC), and has not been widely published widely.
- Stress testing by financial institutions
  - The implementation of stress testing in Vietnamese banks is still new, with simple and limited techniques. Moreover, internal stress testing has not attracted interest from management board to be a regular exercise for risk management and capital allocation.

Application of stress testing for Viet Nam's banking sector

- Stress testing by international organizations
  - Viet Nam has participated in Financial Sector Assessment Program since July 2012 and completed the first assessment in August 2014. However, stress testing was not included in the Report.
- Stress testing in independent studies
  - Nguyen Minh Sang và Nguyen Thi Thu Trang (2013): liquidity test
  - Phung Duc Quyen (2013) và Nguyen Hoang Thuy Bich Tram (2014): solvency tests

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Constructing a stress test for selected Vietnamese banks in 2015

- Coverage
- Identification of risk and vulnerabilities
- Shock calibration and implementation of the scenario
- Mapping from macroeconomy to banks' portfolios
- Interpretation of results

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Coverage

- Joint Stock Commercial Bank for Investment and Development of Viet Nam
- Viet Nam Bank for Industry and Trade
- Joint Stock Commercial Bank for Foreign Trade
- Asia Commercial Joint Stock Bank
- Viet Nam Export Import Commercial Joint Stock Bank
- Military Commercial Joint Stock Commercial Bank
- Maritime Joint Stock Commercial Bank
- Petrolimex Group Joint Stock Commercial Bank
- Saigon Commercial Joint Stock Bank
- Saigon Hanoi Joint Stock Commercial Bank
- Saigon Thuong Tin Joint Stock Commercial Bank
- Viet Nam Technological and Commercial Joint Stock Bank
- Viet Nam Prosperity Joint Stock Commercial Bank

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Coverage

Country	Year(s)	No. of banks	Proportion of banks' assets
The United States	2009, 2010, 2012	19	66%
Mexico	2012	10	84%
China	2011	17	66%
Turkey	2012	9	80%
The United Kingdom	2011	7	71.1%
Viet Nam (Phung Duc Quyen, 2012)	2012	17	70.2%
Viet Nam (this study)	2015	13	68.5%

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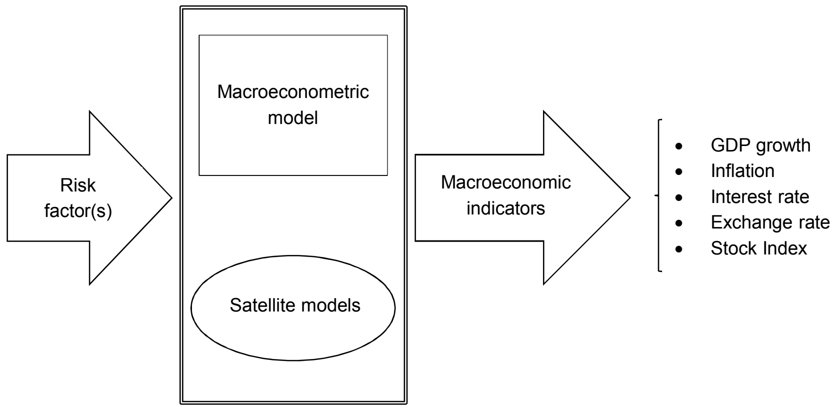
Identification of risk and vulnerabilities

- Credit risk
- Interest rate risk
- Exchange rate risk
- Security price risk

Shock calibration and implementation of the scenario



Source: Quagliariello (2009)

Scenario 1

- Constructing a VAR model for quarterly GDP growth, inflation, lending rate and nominal VND/USD exchange rate from QI/1996 to QIV/2014, and an ARIMA model for monthly VN-Index from M7/2000 to date, then choosing 1% ‘tail’ events in probability distribution (for severity and plausibility).

	2013	2014	2015
GDP growth	5.42%	5.98%	2.79%
Inflation	6.59%	2.56%	22.34%
Lending rate	10.37%	8.67%	16.42%
VND devaluation rate		1.03%	10.30%
VN-Index	504.63	545.63	438.58

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Scenario 2

- Choosing extreme episodes of the economy between QI/1996 and QIV/2014, with lowest GDP growth, and highest inflation, lending rate and VND devaluation. For VN-Index, choosing the episode of the largest decrease of the index, and use 2014 index to calculate 2015 index.

	2013	2014	2015
GDP growth	5.42%	5.98%	4.77%
Inflation	6.59%	2.56%	19.89%
Lending rate	10.37%	8.67%	20.10%
VDN devaluation		1.03%	18.68%
VN-Index	504.63	545.63	403.28

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Mapping from macroeconomy to banks' portfolios

- Credit risk
  - Estimating non-performing loans based on banks' loan classification and provision rates required by SBV. It is assumed that for the next financial year, 5% of special mentioned loans would become sub-standard, 20% of sub-standard loans would become doubtful, 50% of doubtful loans would become loss loans and be added to previous year's loss loans.
  - All types of loans are also assumed to increase by 10% in the next financial year. This assumption is valid as banks often set a target of 13-15% in 2014. These assumptions are also applied in 2015.
  - The predicted non-performing loans are then use to estimate the amount of provisions (based on requirement from SBV)

Mapping from macroeconomy to banks' portfolios

- Interest rate risk
  - Applying a repricing gap model
  - Change in net interest income (ΔNII) is calculated from cumulative repricing gap and change in interest rate, based on the following equation:

    $\Delta NII = CGAP \times \Delta R$
- Exchange rate risk
  - Applying a sensitivity test for net open position. Negative or positive net open position decides whether banks may lose or benefit when exchange rate increases. Information on net open position can be found in the note on currency risk of banks' financial statements.

Mapping from macroeconomy to banks' portfolios

- Security price risk
  - Security price risk is calculated as the decrease in value of investment and trading securities in banks' balance sheet.
- Impacts of all risk factors to banks
  - Credit risk, interest rate risk, exchange rate risk and security price risk will be deducted from banks' profit. If their profit cannot cover these risks, banks' capital will be affected.
  - Banks' capital and risk-weighted assets, estimated by the methodology of Schmieder, Puhr & Hasan (2011), will be used to calculate banks' CAR in 2015.
  - Banks' CAR will then be used to estimate SBV's recapitalization cost.

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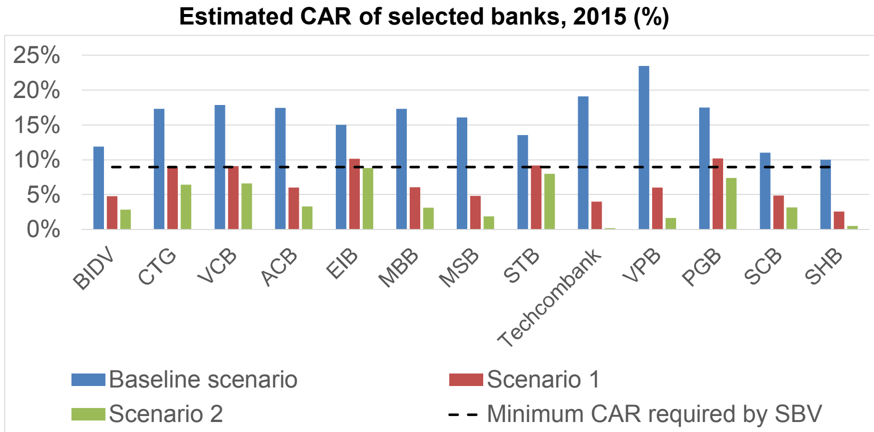
Mapping from macroeconomy to banks' portfolios



Recapitalization costs for the two scenarios are 1.50% and 2.97% of GDP in 2015, respectively.

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Conclusion

- Results of the stress test show the vulnerability of Vietnamese banks under extreme shocks, as their CAR cannot remain above the minimum level required by SBV.
- In this study, authors were unable to collect all data for the whole banking sector, thus the results can only reflect a part of the picture.
- The assessment of credit risk still face difficulties because of the lack of sufficient and reliable time-series data to predict non-performing loans in the future. Liquidity risk and contagion risk still cannot be included in the test.

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Policy recommendations

- Banks should retain more profits or mobilize more capital from current shareholders and external investors. This has not been done in recent years, especially in the absence of practical scheme of non-performing loan disposal
- Banks can also reduce their risk-weighted assets by cutting high-risk assets and increasing low-risk assets, like collecting more debt, keeping more liquid assets and decreasing lending.
- Banks also need to undertake stress tests by themselves or provide information and data for supervisory authorities or researchers.
- Finally, in order to avoid macroeconomic shocks, the banking sector should operate in a stable environment, which is a result of synchronous monetary and fiscal policies, in both short-term and long-term.

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Chapter 5:

Gains and Losses from the TPP: An Assessment for Viet Nam using GTAP Model

Ken Itakura
Nguyen Thi Thu Hang
Nguyen Thi Linh Nga
Nguyen Thanh Tung

VEPR **Contents**

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Introduction

- Integration always brings opportunities and challenges to participating countries and indirectly affects the outsiders.
- Aim of the study: a quantitative evaluation of potential economic impact of liberalizing trade in goods and services under the TPP on Viet Nam.
- Study uses GTAP data base version 9 (published in 2015) and assumes 100% tariff removal plus reduction in non-tariff barriers

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Overview of TPP

- Negotiation progress: 12 members and 19 official rounds up to date
- 5 main characteristics: (i) comprehensive market access, (ii) fully regional agreement, (iii) cross-cutting trade issues, (iv) new trade challenges, (iv) living agreement
- The tentative content consists of 29 chapters, of which 14 chapters have finished negotiation up to May 2015, such as: *Customs, Services, Government Procurement, Sanitary and Phytosanitary Standards, Temporary Entry*, etc.

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Viet Nam's trade with TPP partners

- Exports
  - Increase continuously, yet unstable share in total exports of Viet Nam, dropping from the peak of about 50% to 38-39% currently.
  - The US and Japan are two main markets of Viet Nam's exports to TPP partners
- Imports
  - Share of imports from TPP decreases gradually (to 23% of total Viet Nam's imports in 2014), replaced by imports from China (29.6%)
  - Major partners: Malaysia, Singapore, Japan and the US

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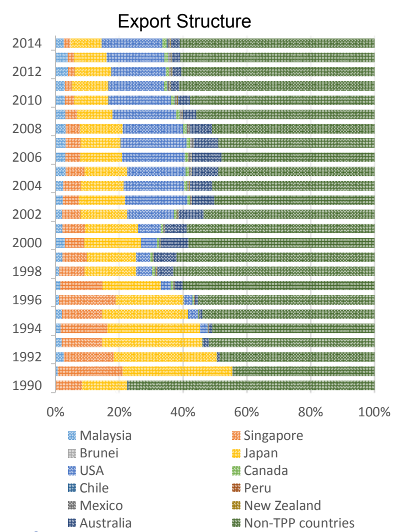
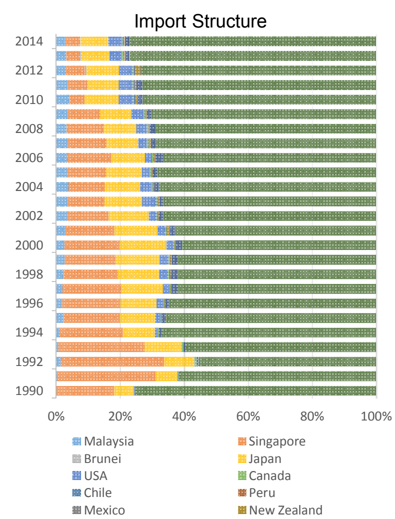
Viet Nam's trade with TPP partners

- Trade structure of Viet Nam by partners:





VEPR Viet Nam's trade with TPP partners

- Trade structure by commodities
  - Exports
    - Concentrated into labour-intensive industries such as apparel, footwear, furniture, etc.
    - For these commodities, Viet Nam has RCA>1 (Nguyen Hong Son et al., 2014)
  - Imports
    - Main imports: machinery, electrical & electronic equipments; mineral fuels, oils & distillation products (account for 35% of imports from TPP partners)
    - Other main imported commodities: plastic; iron&steel (from Japan);

VEPR Literature Review

- Previous studies assessed TPP's impacts on TPP and non-TPP economies, using GTAP database version 8 (baseyear 2007)
  - Static CGE: Todsadee, Kameyama và Lutes (2012); Petri, Plummer and Zhai (2012); Kawasaki (2014)
  - Dynamic CGE: Itakura and Lee (2012) and Cheong (2013)
- Those studies shows that Viet Nam will gain the largest percentage change in real GDP and welfare

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TPP Impact Assessment for Viet Nam

- **GTAP Model**
- **Data and Description**
- **Assumptions and scenarios**
- **Simulation results**

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GTAP Model

- The standard GTAP model is a comparative static general equilibrium model of global trade
- It assumes perfect competition, constant returns to scale of production technology, and differentiation of trades based on the place of origin (Armington 1969).

VEPR Data and Description: Database

- GTAP Database version 9 (Narayanan, Aguiar, and McDougall 2015):
  - 140 regions/countries
  - 57 industrial sectors
  - Benchmark year: 2011
- Aggregated GTAP database:
  - 23 regions
  - 22 sectors

VEPR Data and Description: Regional Aggregation

No.	*Regions*	*GTAP 140 regions*
1	VietNam	Viet Nam.
2	Australia	Australia.
3	NewZealand	New Zealand.
4	Japan	Japan.
5	Brunei	Brunei Darassalam.
6	Malaysia	Malaysia.
7	Singapore	Singapore.
8	Canada	Canada.
9	US	United States of America.
10	Mexico	Mexico.
11	Chile	Chile.
12	Peru	Peru.
13	Cambodia	Cambodia.
14	Indonesia	Indonesia.
15	Laos	Lao People's Democratic Republ.
16	Philippines	Philippines.
17	Thailand	Thailand.
18	RoSEAsia	Rest of Southeast Asia.
19	China	China; Hong Kong.
20	Korea	Korea.
21	India	India.
22	EU_25	Austria; Belgium; Cyprus; Czech Republic; Denmark; Estonia; Finland; France; Germany; Greece; Hungary; Ireland; Italy; Latvia; Lithuania; Luxembourg; Malta; Netherlands; Poland; Portugal; Slovakia; Slovenia; Spain; Sweden; United Kingdom.
23	RestofWorld	Rest of the World

Source: GTAP Database 9

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Data and Description: Sector Aggregation

No.	Sectors	GTAP 57 Sectors
1	Rice	Paddy rice; Processed rice.
2	OthCrops	Wheat; Cereal grains nec; Vegetables, fruit, nuts; Oil seeds; Sugar cane, sugar beet; Plant-based fibers; Crops nec.
3	Cattle	Cattle,sheep,goats,horses.
4	OAP	Animal products nec.
5	CMT	Meat: cattle,sheep,goats,horse.
6	OMT	Meat products nec.
7	RawMilk	Raw milk.
8	Dairy	Dairy products.
9	Forestry	Forestry.
10	Fishing	Fishing.
11	CMOG	Coal; Oil; Gas; Minerals nec.
12	ProcFood	Vegetable oils and fats; Sugar; Food products nec; Beverages and tobacco products.
13	Textiles	Textiles.
14	Apparel	Wearing apparel.
15	LSMnfc	Wool, silk-worm cocoons; Leather products.
16	WoodProducts	Wood products; Paper products, publishing.
17	MProc	Petroleum, coal products; Chemical,rubber,plastic prods; Mineral products nec; Ferrous metals; Metals nec; Metal products.
18	ElecEquip	Electronic equipment.
19	OthMnfc	Motor vehicles and parts; Transport equipment nec; Machinery and equipment nec; Manufactures nec.
20	Util_Cons	Electricity; Gas manufacture, distribution; Water; Construction.
21	TransComm	Trade; Transport nec; Sea transport; Air transport; Communication.
22	OthServices	Financial services nec; Insurance; Business services nec; Recreation and other services; PubAdmin/Defence/Health/Educat; Dwellings.

Source: GTAP Database 9

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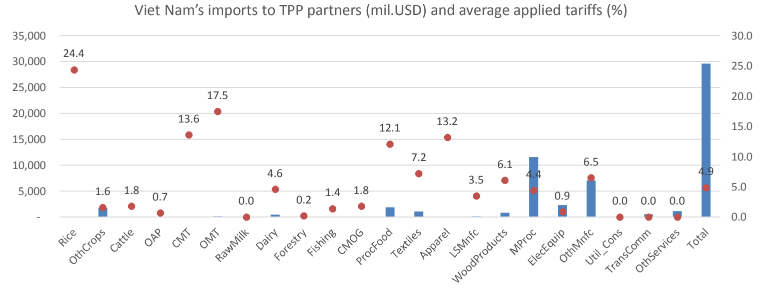
Data and Description: Imports and Tariff

- Viet Nam’s imports and Average applied tariff: imports from TPP partners account for ¼ of total imports of Viet Nam (~30 bil. USD), average applied tariff is 4.9%
- Main commodities: chemical and metal (Mproc), other manufacturing (OthMnfc), import values reach 12 and 7 bil.USD, average applied tariffs are 4.4% and 6.5% respectively.

Viet Nam’s imports to TPP partners (mil.USD) and average applied tariffs (%)



Source: GTAP Database 9

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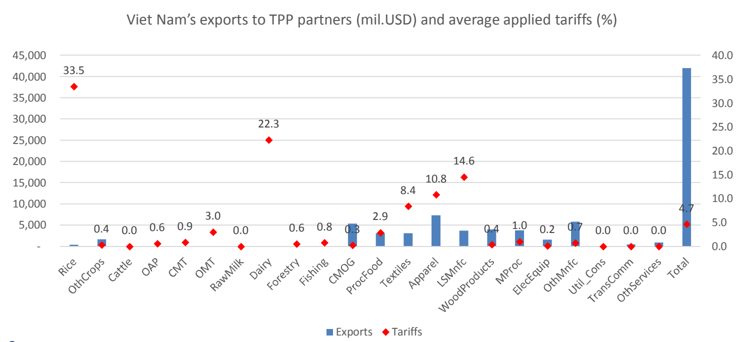
Data and Description: Exports and Tariff

- Main exported commodities: Apparel (~7,3 bil. USD) with relatively high average applied tariff (10.8%).
- The highest applied tariffs are in Rice (33.5%) and Dairy (22.3%). However, the export value of these commodities are insignificant.



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Data and Description: Non-tariff barriers

- Non-tariff barriers:
  - tariff equivalents of services trade barriers (Thelle, *et al*. (2008), Wang, *et al*. (2009)
  - average cost of time delays in trade (Minor, 2013).
- These NTBs are difficult to removed completely due to the existence of nature barriers such as language, etc.
- This study chose the maximum possible reduction of NTBs (by 7%) (Hayakawa and Kimura, 2014)

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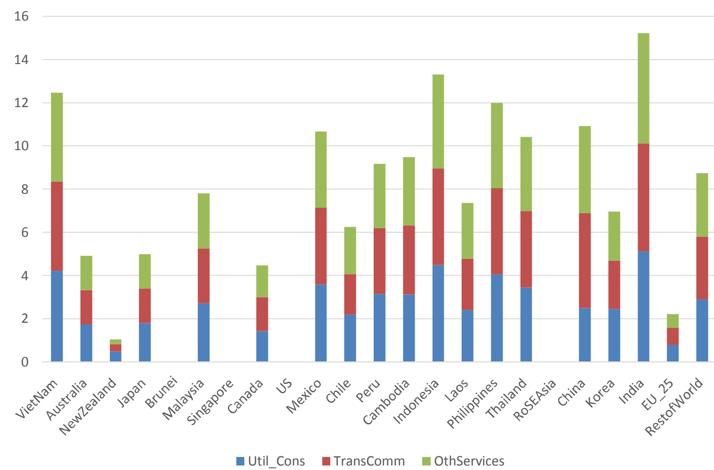
Data and Description: Services trade facilitation

- The size of reduction in tariff equivalents of services trade (%)*



*: Note that Singapore and US are used as benchmark countries, and Brunei doesn't have estimate due to data limitation.

Source: Author's calculation, based on Wang, et al. (2009) and Hayakawa and Kimura (2014)

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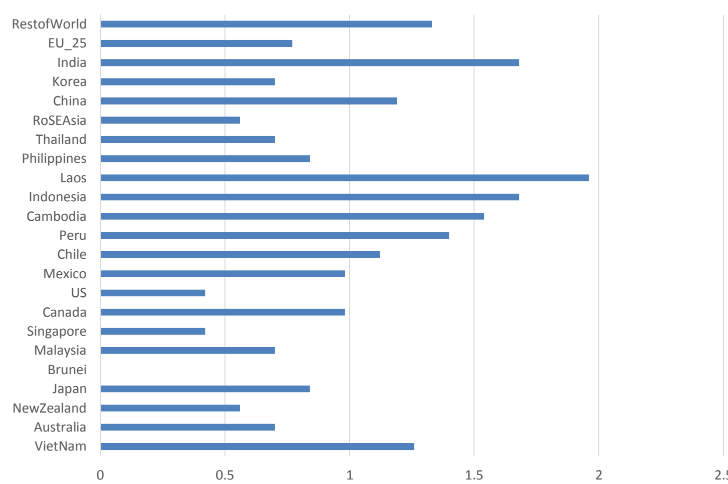
Data and Description: Reduction of time delays

- Time delays to be reduced (days)



Source: Author's calculation, based on Minor (2013) and Hayakawa and Kimura (2014)

VEPR Assumptions and Scenarios

- **Assumptions:**
  - No explicit treatment of time
  - Perfectly competitive markets
  - Constant returns to scale production technology
  - Fixed endowments of primary factor inputs such as land, natural resources, capital, skilled and unskilled labor
  - Goods and services are allowed to move across borders but not for the primary factors
- **Scenarios:**
  - Scenario a: Tariff removal for the TPP countries.
  - Scenario b: a + 7% reduction in non-tariff barriers for TPP countries.
  - Scenario c: a + 7% reduction in non-tariff barriers for all the 23 regions.

VEPR TPP Simulation Results

- Simulation results for real GDP
- Simulation results Investment
- Change in imports and exports
- Simulation results for output
- Change in Demand for skilled and unskilled labor
- Simulation results for Welfare

VEPR Simulation results on real GDP

- Viet Nam's increase in real GDP stands out in percent change for all three scenario, 1.03%, 1.32% and 2.11% respectively.
- Once the global reduction in non-tariff barriers is implemented under the scenario c, then even non-TPP member countries are experiencing gains in real GDP.
- Large increase in investment and consumption in Viet Nam offsetting the considerable increase in imports (11.2%).

VEPR Simulation results on real GDP

	% change			Value change (USD mil.)		
	Scenario a	Scenario b	Scenario c	Scenario a	Scenario b	Scenario c
VietNam	1.03	1.32	2.11	1399	1792	2855
Australia	0.07	0.12	0.20	963	1650	2737
NewZealand	0.06	0.11	0.15	100	181	242
Japan	0.21	0.23	0.28	12435	13800	16597
Brunei	0.19	0.19	0.19	32	32	32
Malaysia	0.14	0.30	0.57	409	865	1657
Singapore	0.01	0.07	0.14	38	190	395
Canada	0.22	0.34	0.41	4002	6031	7263
US	0.00	0.01	0.03	37	1883	4185
Mexico	0.03	0.15	0.22	316	1742	2625
Chile	0.01	0.11	0.26	32	274	641
Peru	0.00	0.10	0.27	7	171	463
Cambodia	-0.16	-0.17	0.74	-20	-21	95
Indonesia	-0.02	-0.02	0.25	-127	-147	2120
Laos	0.01	0.01	0.69	1	1	57
Philippines	-0.01	-0.02	0.27	-32	-37	611
Thailand	-0.06	-0.07	0.58	-208	-237	1993
RoSEAsia	-0.01	-0.01	0.04	-3	-4	24
China	-0.03	-0.03	0.17	-1988	-2245	12855
Korea	-0.03	-0.04	0.22	-363	-433	2627
India	-0.01	-0.01	0.52	-203	-252	9723
EU_25	0.00	0.00	0.17	-666	-832	29760
RestofWorld	-0.01	-0.01	0.34	-847	-1125	50138

Source: Authors' calculation

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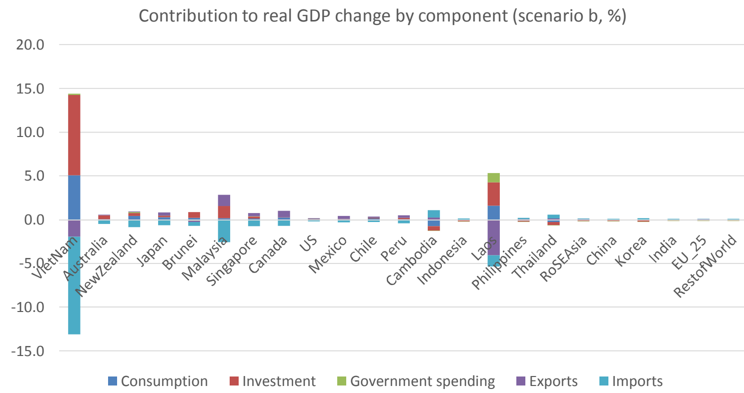
VEPR Simulation results on real GDP

- In scenario b, investment and consumption increase by 9.18% and 5.09% respectively, plus an rise in government spending by 0.15%. Exports decrease slightly (1.93%) while imports surge (11.17%). As a result, real GDP increae by 1.32%.



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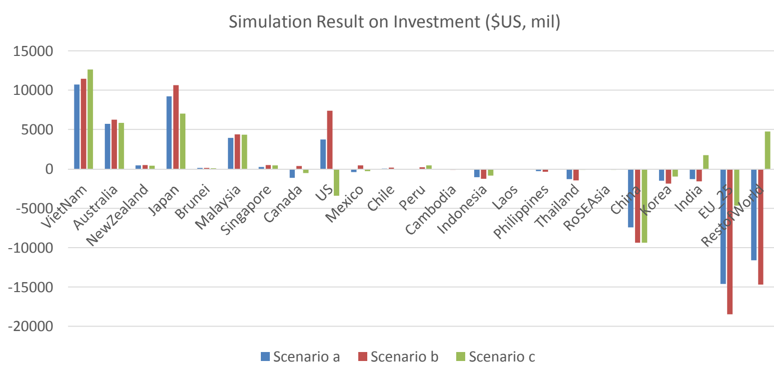
VEPR Simulation results on investment

- The increase in investment in Viet Nam is outstanding as compared to other countries.

  =>TPP will stimulate Viet Nam's fixed capital formation that is defined as investment in the model.



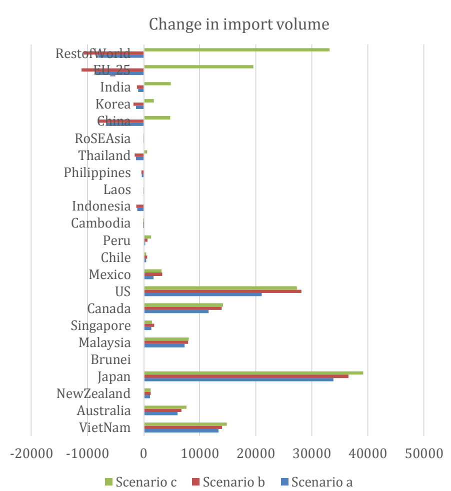
Source: Author's simulations

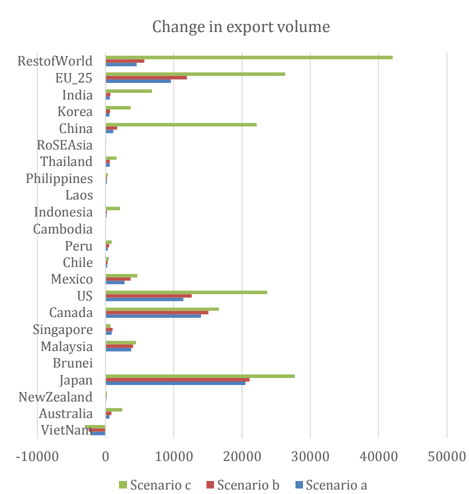
VEPR Change in trade value

- Imports
  - Change in import volume to Viet Nam is also significantly large in terms of percentage change.
  - Japan shows the largest change in export volume in absolute term (over 33 bil.USD)
- Exports
  - Viet Nam shows negative export volume changes (-2.2 to -3.1 bil.USD or -2.2% to -3.1%).
  - There is a shift of Viet Nam's export destinations away from non-TPP countries to TPP members
- Reasons for the decrease in exports
  - Competition between foreign and domestic firms help lower the world price
  - Domestic consumption surges (6.9 bil. USD in scenario b) while domestic output increases weakly (2.4 bil. USD), leading to the short of export supply
  - The inflexibility of sources constraints the utilization of the liberalization

VEPR Change in trade value

- Change in trade value ($US, mil)





Source: Author's simulations

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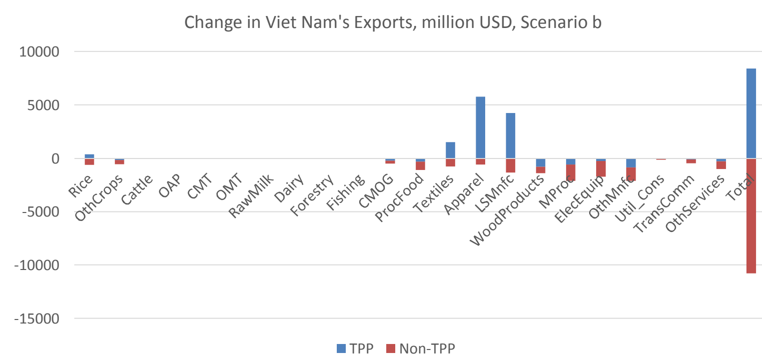
Change in Viet Nam's exports

- Change in Viet Nam's exports to TPP and Non-TPP countries by sectors

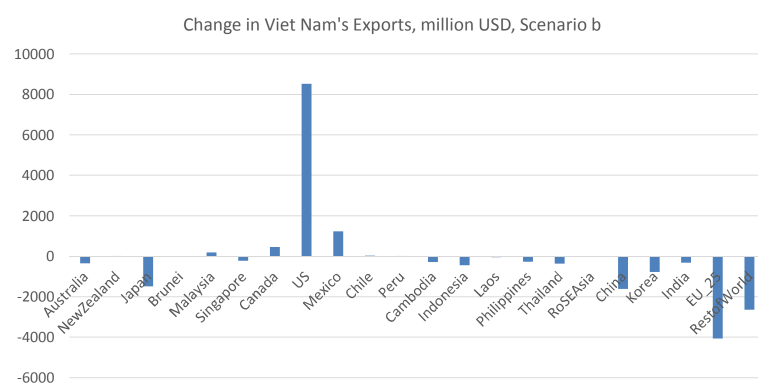


Source: Author's simulations

VEPR

Change in Viet Nam's exports

- Change in Viet Nam's exports by countries/regions



Source: Author's simulations

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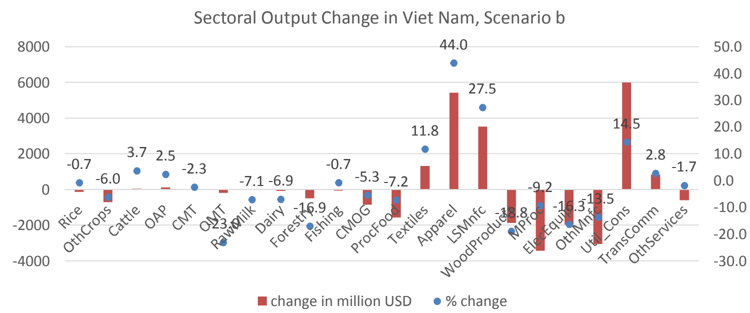
Change in output

- Corresponding to the larger increases in sectoral export volume, Apparel, LSMnfc, and Textile expand its production approximately by $5.4 billion, $3.5 billion, and $1.3 billion.
- Notice that Util_Cons increases its output to support the large fixed capital formation for investment demand.



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Change in demand for skilled and unskilled labor

- **Change in demand for skilled and unskilled labor, Scenario b:**
  - In terms of % change, Apparel shows more than 40% change in demand both for un-skilled and skilled labor.
  - However, in absolute term measured in million US dollar, Util_Cons resulted in $0.7, $0.8, $0.9 billion for un-skilled labor, and about $400 million for skilled labor, to meet the investment demand.
  - Note that the sum of the absolute changes will be zero, meaning that the resource constraint is binding so as the expansions and contractions of labor demands are offsetting each other.

Good Policy, Sound Economy

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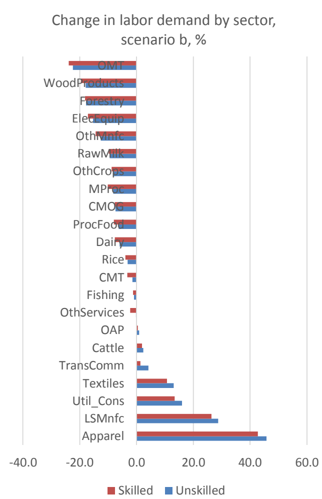
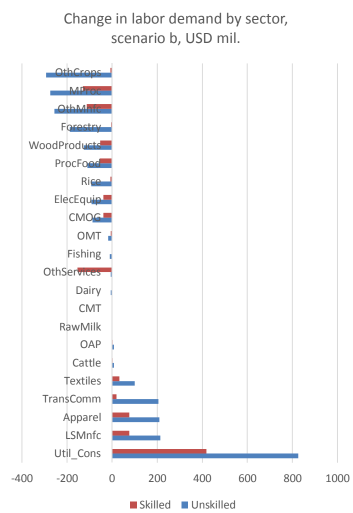
Change in demand for skilled and unskilled labor

- **Change in demand for skilled and unskilled labor, Scenario b:**





Source: Author's simulations

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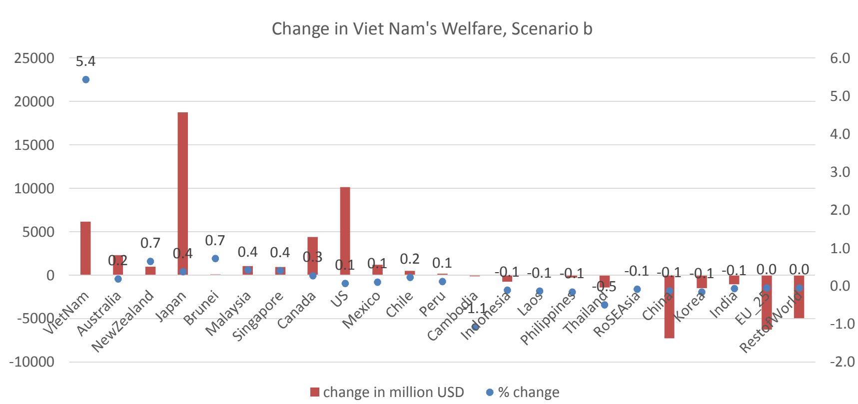
Change in Output Welfare

- All the countries participating in the TPP shows improving economic welfare. In % change term, Viet Nam's gain in economic welfare is the largest among the regions:



Source: Author's simulations

VEPR Conclusion and policy implications

- Simulation results show that Viet Nam will experience the largest percentage increase in real GDP and welfare
- This increase thanks mainly to the rise in investment and consumption
- Imports surges while exports decrease, leading to larger trade deficit
- Labour will move from the agricultural sectors towards the more advantage industries (apperal, textiles, footwear and utility services)

VEPR Conclusion and policy implications

- Policy Implications
  - Need to pursue institutional reforms and liberalize the primary input factors
  - Need to offset the loss in tax revenue due to the tariff removal
  - In need of suitable supporting policies to promote the industries with comparative advantage
  - Encourage research and implementation of suitable technical barriers facing the tariff removal
  - Need to attract and utilize the increasing investment flows (both domestic and foreign investment)

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Chapter 6:
Toward the Sustainable Integration of Viet Nam's Rice Market: A Market Structure Approach

Nguyen Duc Thanh
Dinh Tuan Minh
Nguyen Quang Thai

VEPR Contents

VEPR Introduction

- **Traditional Policies:** increasing rice production and export
- **Traditional issues:**
  - Farmers are continuously put under the pressure of reducing prices and stand at market risks
  - Raising the risks of soil quality reduction
  - Difficulties in finding out export market for the high quality rice
  - Do not establish Vietnamese own rice brand name
- **The international rice market structure changes:** growing competitiveness pressure, rice consumption is predicted to decrease slightly from 2030.

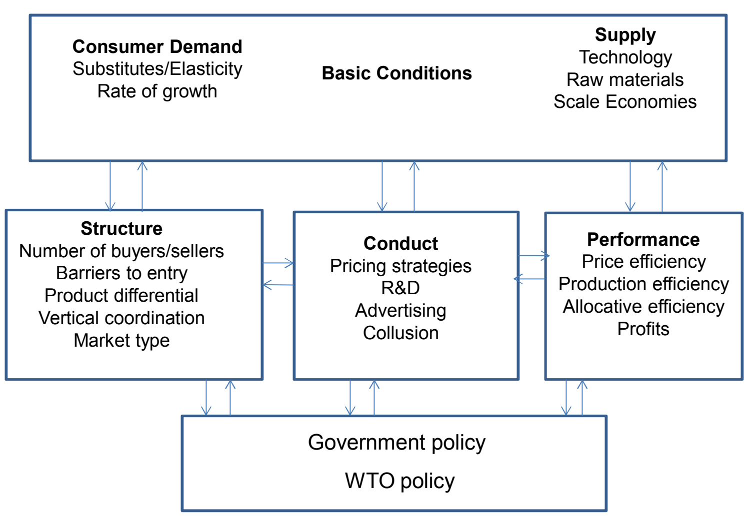
VEPR Objectives

- Analyzing the international rice market structure -> the basis to determine rice sector orientation
- Identifying Viet Nam's rice market structure, conduct and performance: stakeholders, their functions, power, payoffs, costs and benefits for each payoff
- Determining the impacts of market structure on the sustainable development of Viet Nam's rice market
- Recommend policies based on stakeholders' performance

Methodology – Theoretical framework

- The theory of Structure-Conduct-Performance in industrial organization theory
  - Divide into two segments
    - The segment of trading paddy rice
    - The segment of trading rice (husked rice)
      - Segment of rice export
  - Identify market structure in each segment
  - Identify segment interaction

The traditional SCP Paradigm



Source: Kang, Kennedy, & Hilbun (2009)

Methodology

- Analyzing production model in Mekong Delta
- In-depth interviews in Can Tho and An Giang:
  - 72 farmers;
  - 07 collectors;
  - 10 millers;
  - 05 domestic wholesalers;
  - 09 exporter;
  - Local authorities

The international rice market structure

- Production and Consumption
- Most countries produce rice for provide domestic consumer demand, exports accounts for a relatively small proportion of total rice production in each country
- Food securities: Ending stocks amounting to 20-24% of total rice production between 2010-2014

Production and consumption in selected countries, 2014 (thousand tons)

Nation	Production	Consumption	Export	Import
China	142,530	146,300		4,168
India	106,540	99,180	10,901	
5 countries in ASEAN				
Indonesia	36,300	38,500		1,225
Viet Nam	28,161	22,000	6,325	
Thailand	20,460	10,900	10,969	
The Philipines	12,200	12,850		1,800
Cambodia	4,725	3,650	1,000	
Other countries	125,964	146,713		
Tổng thế giới	476,880	480,093		

Source: USDA (2015)

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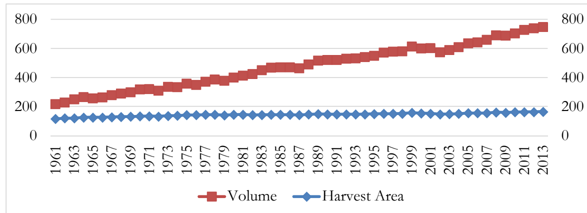
International rice production and consumption

Total Production and Total Area Harvest , 1961-2013
(left: mil. ton; right: mil. hectare)

Productivity determines rice production



Source: FAO (2015)

World Agriculture Prospects, 2020-2050 (mil ton)

	2020	2025	2030	2035	2050
FAO (2002)			535		
FAO (2006)			503		449
FAO (2012 revision)					465
Timmer, Block & Dawe (2010)					
Best judgement	450	440	430		360
Rapid income growth		414	390		255
Slow income growth	466	469	466		404
Rejesus, Mohanty & Balagtas (2012)					
Point forecast (middle)	491	517	544	570	651
Lower forecast interval	437	446	457	469	504
Upper forecast interval	545	588	630	672	797
GRiSP (2010)	496		535	555	

World's rice supply tends to rise

From 2030: consumer demand starts to slightly decrease.

Source: Jong-Ha Bae (2014)

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World rice trade

- Major exporters: Thailand, India, Viet Nam, more concentrated than importers
- 2014: rice export accounts for 8.97% of rice production;

05 major exporters and importers, 2013/2014

STT	Major exporters			Major importers		
	Country	Quantity (mil tons)	Share (% of trade)	Country	Quantity (mil tons)	Share (% of trade)
1	Thailand	11.0	25.48%	China	4.2	9.68%
2	India	10.9	25.32%	Nigeria	3.2	7.43%
3	Viet Nam	6.3	14.69%	Philippines	1.8	4.18%
4	Pakistan	3.3	7.66%	Iran	1.7	3.83%
5	USA	3.0	7.07%	EU	1.6	3.61%

Source: USDA (2015)

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Comparisons of CR4 and HHI between Exporting and Importing Countries, 2000-2008

Rice exporting countries have more power for than rice importing countries due to production concentration in Asia

Year	Exporting countries		Importing countries	
	CR4	HHI	CR4	HHI
2000	0.6246	1244.5196	0.3970	437.3198
2001	0.6351	1325.3535	0.4562	600.5746
2002	0.7336	1521.9866	0.4704	588.7627
2003	0.7109	1389.8240	0.4890	781.4017
2004	0.7613	1905.5646	0.4463	841.5337
2005	0.7238	1385.1611	0.5126	1143.0204
2006	0.6897	1294.9176	0.4695	900.5110
2007	0.7110	1461.5192	0.4992	899.6914
2008	0.7028	1474.0022	0.4863	878.8563

Source: Kang, Kennedy and Hilbun (2009)

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Export competitiveness pressure

- In the medium-term, export competitiveness tends to rise
- ✓ Towards Self sufficiency strategies for rice import countries like the Philippines, Indonesia and African countries;
- ✓ Emerging exporters: Cambodia, India and Myanmar

Emerging exporters and traditional importers 2009 -2014 (thousand ton)

		2009/2010	2010/2011	2011/2012	2012/2013	2013/2014
Emerging exporters	India	2,228	4,637	10,250	10,480	10,901
	Cambodia	750	860	1,000	1,075	1,000
	Myanmar	700	1,075	1,357	1,163	1,300
Traditional importers	Malaysia	907	1,076	1,006	885	989
	Chi	366	575	2,900	3,483	4,168
	Indonesia	1,150	3,098	1,960	650	1,225

Source: 2009/10: USDA (2014a); 2010/11 – 2013/14: USDA (2015)

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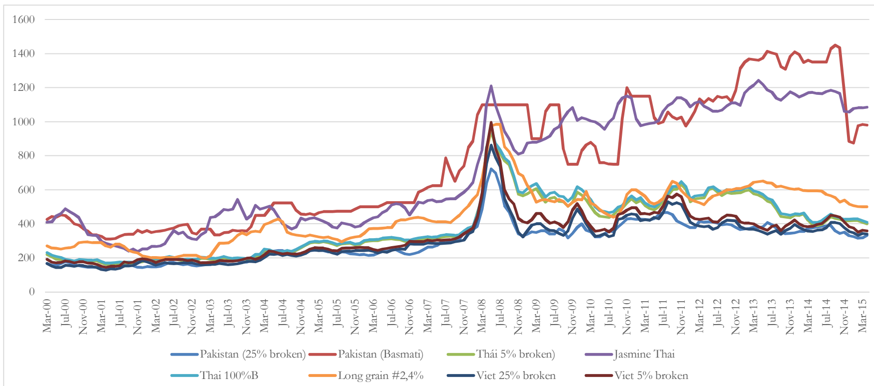
Rice Export Prices by type, 3/2000-4/2015 (USD/ton)

- Exporters face difficulties in setting prices (tough to establish rice export cartels) -> choose the payoffs to invest R&D to raise their power (Thailand, Pakistan)



Source: FAO (2015b)

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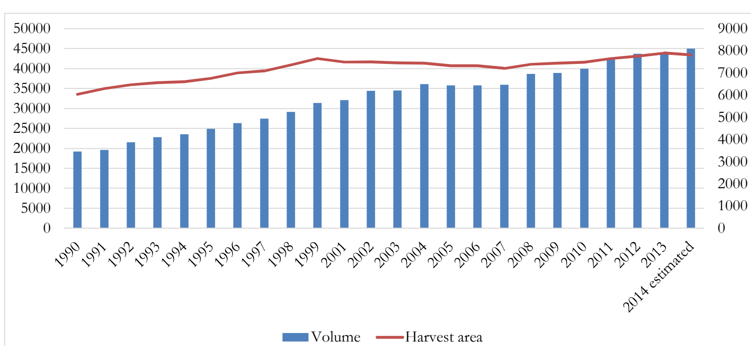
Viet Nam's rice production and consumption

- Production and yield increase continuously (5.6 ton/ha in 2012, compared to 4.5 tons/ha of world rice yield)

Viet Nam rice production and consumption, 1990-2013
(left: thousand hectare, right: thounsand ton)



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Viet Nam's rice production

Harvest area for 3 seasons/year increased: using more pesticides, reducing rice quality, soil quality reduction etc.

Changes in intensive farming, 1980-2010

Harvest area (m^2)	1980	1990	2000	2010
1 season/year	1,572,800	887,277	431,389	342,250
2 seasons/year	642,500	1,154,046	1,398,062	1,057,366
3 seasons/year	23,000	50,237	237,310	529,270
Total Areas	2,238,300	2,091,560	2,066,761	1,928,886
Total area for cultivation	2,926,800	3,346,080	3,939,443	4,044.792
Cultivation density (season/year)	1.31	1.60	1.91	2.10

Source: ISGMARD (2011)

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Rice production cost, 2012

	Average cost	
	Cost (thousand VND/ha)	Share (%)
Seed	1,554	7
Fertilizers	7,460	35
Pesticide	987	5
Irrigation fee	187	1
Labor (hired)	1,589	7
Hired equipment	488	2
Land fee	667	3
Commercial fee	1,494	7
Labor (self-employed)	2,841	13
Interest (bank loan)	1,824	9
Depreciation	2,361	11
Sum	21,450	100

Source: Dao The Anh, Thai Van Tinh, Nguyen Van Thang, and Vu Nguyen (2013)

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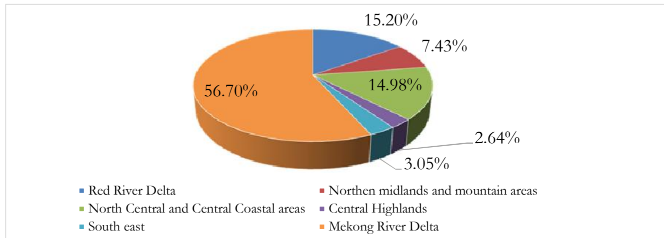
Rice production

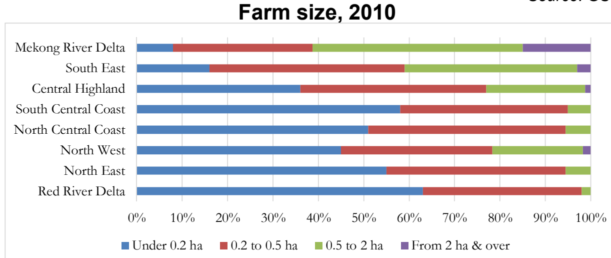
Rice production by region, 2013 (%)



- Largely produce in Mekong Delta

Source: GSO (2014)

Farm size, 2010



- Mainly small farm size (0.44 ha/household on average; in Mekong Delta: 1.2 ha/household)

Source: Oxfam (2013)

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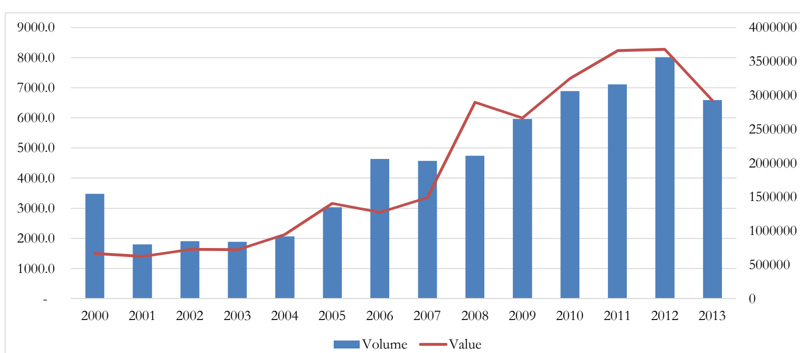
Viet Nam's rice export, 2000 -2013 (left: thousand ton, right: thousand USD)

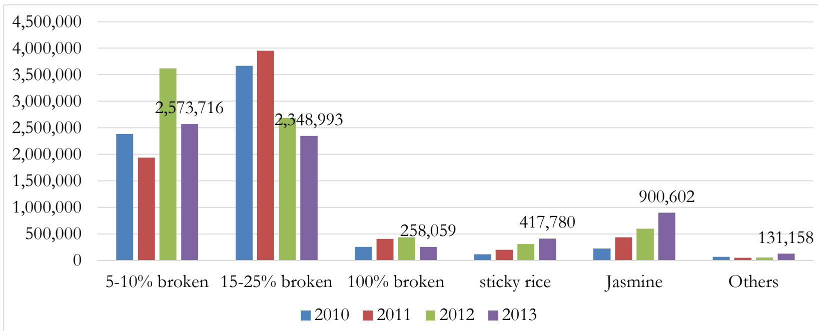
- ❑ Rice export accounted for about 20% of Viet Nam's rice output and 14% total world rice export
- ❑ Volume and value rice export soared from 2005.
- ❑ Exported rice largely comes from Mekong Delta, amounting to 95% Viet Nam's rice export.



Source: UN Comtrade (2015)

Major types of exported rice, 2009 - 2013 (ton)

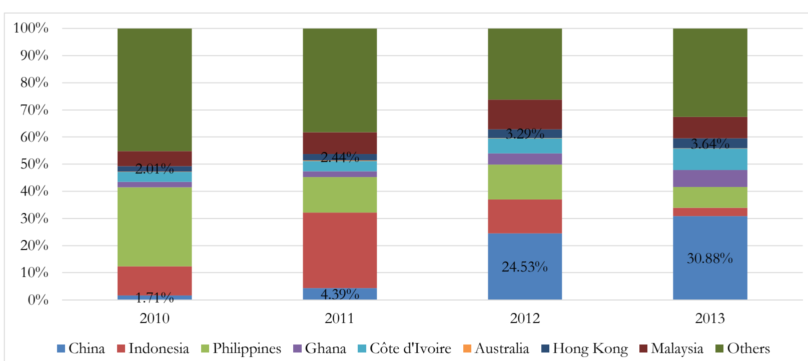
- Low quality types (long grain, 5% and more broken) constituted to over 40% of export volume
- Jasmine export volume increase constantly to 0.9 million ton in 2013.



Source : USDA (2014c)

Rice export by destination, 2010-2013 (% export value)

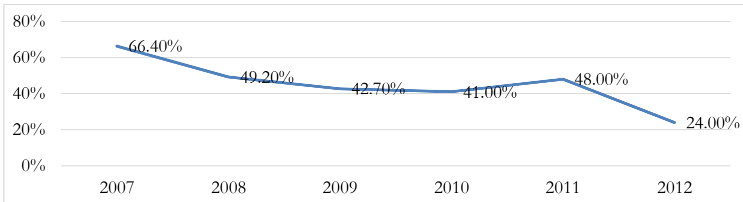
- The proportion of rice export to China soared rapidly
- Shares of rice exported to Hong Kong, Singapore, Australia tended to increase
- Shares of rice exported to Indonesia and The Philippines tended to fall considerably



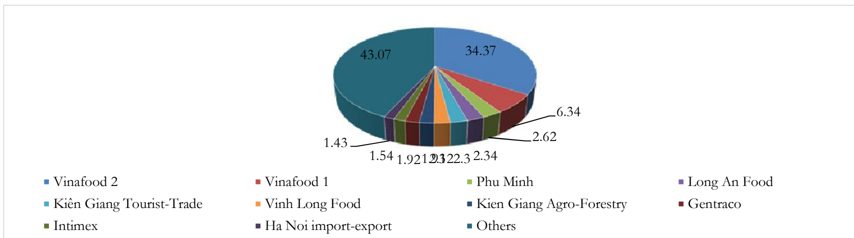
Source : UN Comtrade (2015)

VEPR Viet Nam's rice export

Proportion of G2G export volume, 2007-2012 (%)



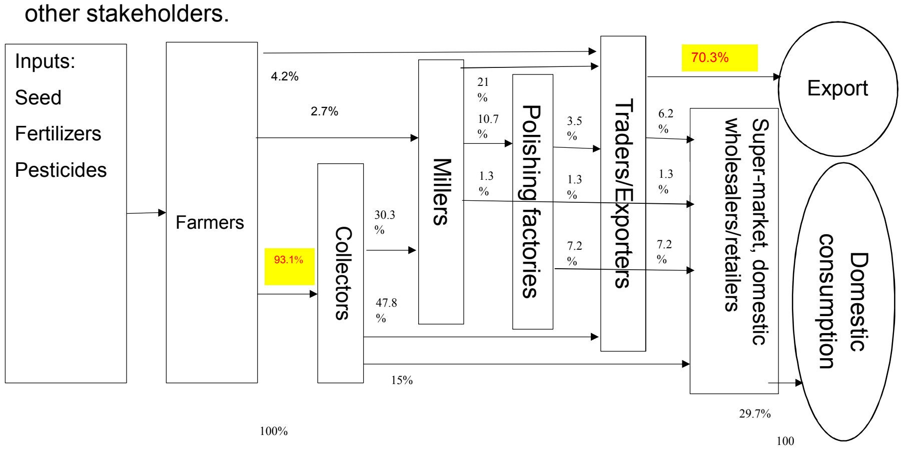
Top 10 Viet Nam's rice exporters, 2012 (%)



Source: Agromonitor (2014)

VEPR Viet Nam's Rice Value Chain, 2010

- Exporters negotiate rice price in the world market, this price is transmit vertically into domestic rice market
- Collectors play an important role in value chain, providing price information for other stakeholders.



Source: Vo Thi Thanh Loc & Nguyen Phu Son (2010)

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Viet Nam's rice market structure: Segment of trading paddy rice

Stakeholders	Role	Number	Power	Possible payoffs: Cost s and Benefits
Farmers with Large-scale farming	Cultivate rice	Few	Relatively small proportion	- Stable consumer demand; - Stable profit - Depend on rice export market - High investment for Technology
Farmers with small-scale farming	Cultivate rice	Too many	Sell paddy rice for collectors	- Unstable demand - Seldom have power on price negotiation
Cooperatives	Households cooperate to produce and sell paddy rice	Few	Power in negotiation with collectors	- Hard to cooperate - High transaction cost - Able to negotiate the high price

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Viet Nam's rice market structure: Segment of trading paddy rice

Stakeholders	Role	Number	Power	Possible payoffs: Cost s and Benefits
Collectors	Purchase paddy rice from farmers, hire or sell to millers; or sell to traders	Too many	More power than farmer when negotiating paddy rice price	-Do not have stable demand - High transaction cost - Low investment, large price gap
Millers	Purchase directly from farmers, collectors	Many	To collectors, hired to mill	- Scores of choices - Various capacities - Self-collect to mill, high warehouse cost - Hired to mill
Exporters	Purchase paddy rice from large scale farming households and self-mill	Few	To large scale farming households	- Just purchase directly from large scale farming households based on their contract - Stable inputs - Risks of export price - Cost for warehouse

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Viet Nam's rice market structure: Segment of trading husked rice

Stakeholders	Role	Number	Power	Possible payoffs: Cost s and Benefits
Millers	Process rice and sell to traders, rice brokers and exporters	Many	Minor role in selling directly husked rice to retailer and exporters	- Many options to choose - Various capacities - High cost for warehouse if purchasing paddy rice
Collectors	Hire millers and provide husked rice for traders or retailers	Many	Role in husked rice collection for traders	- Many options to choose - more power to bargain price with farmers
Brokers and wholesalers	Buy husked rice from millers, collectors and sell directly to exporters and retailers	Many	Essential role in selling rice	- Many options to choose for inputs - Huge Capital

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Viet Nam's rice market structure: Segment of trading husked rice

Stakeholders	Role	Number	Power	Possible payoffs: Cost s and Benefits
Exporters	Self-mill paddy rice from farmers, from suppliers	High concentration	Self-process or collect from other resources	- Buy directly from large farm-sized farmers based on contract - Stable inputs - Risks of rice export price - Cost for warehouse
Viet Nam Food Association	Provide information; regulate exporters			
Government	- Support enterprises to purchase rice for storage - Negotiate the G2G export Etc.		Not clear	

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The tendency of structural changes in Viet Nam's rice market

- Farmers
  - Increase harvest area for each farmers by land accumulation.
  - Create Cooperatives: low degree of feasibility.
  - Vertical linkages through production contracts: broad tendency in years to come
- Collectors
  - Continue to play an important role for farmers not participating in large-scale farming model
  - Coordinate with millers and polishing factories
- Millers
  - Develop and expand production scale
  - Accumulate capital, technology to coordinate with other stakeholders
  - Establish rice brand name to provide for domestic consumers and exporters
  - Coordinate with farmers to create stable inputs
- Export
  - Connect more closely with millers instead of collectors
  - Medium-size exporter role is more and more important to find high quality rice market
- Supermarket
  - more and more important to provide rice in domestic market
  - Connect to millers to access to high quality rice resources

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Discussion on selected polices in rice sector

- **Policies of protecting 3.8 million hectares of harvest area for national food security**

  Rigid policy, using land inefficiently when cultivating paddy rice in some areas, supply surplus.
- **Policy of forming cooperatives**
  - Must be based on farmers' property right
  - Accounting for a small proportion of rice production in rice market structure (Thailand, 6%)
- **Policy of purchasing rice for temporary storage**
  - Low efficiency due to not impact on paddy rice and farmers' benefits
  - Exporters benefit because of subsidized warehouse cost
- **Policy of building rice warehouse in Mekong Delta**
  - Enterprises largely build warehouse for husked rice storage instead of paddy rice
  - Farmers still sell paddy rice to collectors
- **Policy of conditions on rice exporters**
  - Concentrate rice export on some large enterprises: raise the power when negotiating prices, do not encourage to find out niche market
  - Create another intermediary: suppliers for exporters.

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Conclusion and policy recommendations

- The international rice market structure:
  - Growing competitiveness pressure from global export market: countries importing rice implementing self-sufficiency strategies; countries with their own export potential accelerating rice production; rice consumption in Asian countries is expected to peak in 2030, then remains unchanged or decreases slightly
  - Export power based on ability of establishing rice brand name
  - Low quality rice: food security and the poor
- Recommend policy vision:
  - Note the natural development potential of the milling firms which could accumulate the capital, establish vertical linkages.
  - Transfer the orientation of Viet Nam's rice sector into strongly developing domestic rice market: the domestic market ought to perform an important role in building and testing quality standards, brand name of the rice grains produced in Viet Nam.

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Policy recommendations

- **Recommendation 1:** Building and completing Good Manufacturing Practices (GMP) for Vietnam's Rice Mill.
  - These millers are encouraged to abide by GMP-RM and;
  - Be self-responsible for using rice separators based on world standards of rice separation process.
- **Recommendation 2:** Abolish VAT imposed on domestic rice consumption to achieve the equality between domestic wholesalers and exporters.
- **Recommendation 3**: Ease the conditions for rice exporters in Decree 109/2010/ND-CP.
  - Encourage medium-sized enterprises to develop niche market with high quality rice (do not need to abide by Decree 109/2010/ND-CP)

VEPR Policy recommendations

- **Recommendation 4:** Suggest the government implement more flexible policies when planning 3.8 million hectares for rice cultivation, widening the opportunities for farmers to use the land more effectively. Divide this area into 2 types
  - Areas with absolute competitive advantage of rice cultivation: continue to cultivate rice solely.
  - Other areas can cultivate other annual crops if these crops can be more profitable for farmers. The decision on which annual crops should be cultivated in these areas depends entirely on farmers themselves.
- **Recommendation 5:** Identify depreciation of the irrigation system and infrastructure related to rice cultivation; and add the depreciation to rice price, especially export rice price.
- **Recommendation 6:** easing the limited harvest area for each household which would encourage land accumulation for farmers to cultivate in large-scale areas.

VEPR Policy recommendations

- **Recommendation 7:** support the development of adequate microfinance and insurance system for farmers.
- **Recommendation 8:** differentiate between commercial rice and storage rice. VINAFOOD ought to focus on implementing policies (such as to co-ordinate and supervise the rice purchasing for the food security storage policy); diminish their share of commercial distribution towards giving all of this playing ground for private companies.
- **Recommendation 9:** VFA should be reformed toward assuring the participation and the voice of the representatives of private enterprises, local authorities and farmers in the association.
- **Recommendation10:** subsidize costs for the enterprises, coordinating with farmers, establishing paddy rice warehouses instead of rice warehouses, farmers have rights to store temporarily their paddy rice in enterprises' warehouses in the certain time.

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Chapter 7: Viet Nam Economic Prospects 2015 and Policy Implications

Nguyen Duc Thanh

VEPR

Viet Nam Economic Prospects 2015

Year	2011	2012	2013	2014	2015 Scenario 1	2015 Scenario 2
Growth (%)	6,24	5,25	5,42	5,98	6,1	6,3
Inflation (%)	18,90	6,81	6,04	1,84	1,9	3,2

VEPR Short-term issues

- Budget deficit is a problem of 2015 and may prolong to 2016. This reflects the economic structure and the management performance of the central and local government. The use of measures to finance the abnormal deficit in 2015 will determine the macro balances in 2016. For instance, in case that the Government borrows from the forex reserves to finance the budget deficit (even making an advance), this will triggers reactions (in confidence) to monetary and fiscal policy.

- The exchange rate is a pressing issue and needs an adjustment to align with movements of the international money market.

- The current macro balance can be weakened in 2016 and may cause a new cycle of inflation – depreciation

VEPR Fundamental issues

- Given the vulnerability of the banking system, banks may not withstand extreme but plausible shocks. It remains uncertain about the financial soundness of each bank (information asymmetry)
- Orientating production and export industries needs to be more marketized to enhance the competitiveness and the strength of enterprises. Take rice production industry for example, it is recommended to ease the condition for exporters, increase the role of endogenous factor (miller enterprises) to create a foundation for intra-industry vertical integration and form the competitiveness of the industry.
- Viet Nam's benefit from joining TPP is going to be positive and fundamental, which will impact on the economic structure through multiple of channels of effects in industries and areas. The benefit will be greater if the endowments such as capital, labour and land are flexible to move. This correlates strongly with administrative and institutional reforms.

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Policy recommendations

- Flexible monetary policy to realign the VND; maintain or build up forex reserves to strengthen the confidence in monetary policy
- Carry on reforms and restructure of the banking system to create a premise for the recovery of profit margin and recapitalization of the banking system. Restructure high-risk portfolios.
- Apply technical barriers to trade for imported goods and raise awareness about technical barriers erected by export markets.
- Strongly reform the internal institutions to enhance the flexibility of endowments which will facilitate across-border movements.
- Nevertheless, the long-term issues are raising productivity and added value. They requires simultaneous reforms in administration, institution and schemes in each enterprises to increase its productivity and efficiency.

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Policy recommendations

- In order to be more involved in the integration process, as well as to reap more benefit from the freedom of navigation and marine security, we recommend Viet Nam to proposal for an establishment of the Pan–Asia Marine Economic Cooperation – PAMEC). This organization should aim to build a hi-quality marine infrastructure, connecting most significant marine economies between the Indian Ocean and the Pacific Ocean, establishing a united bloc for common prosperity and security.

- **PAMEC** can be built on the basis of these potential founding member candidates (alphabetical order): Australia, Canada, China, Japan, India, Indonesia, New Zealand, Malaysia, Myanmar, Philippines, Singapore, Sri Lanka, Taiwan, Thailand, Vietnam, and the United States.

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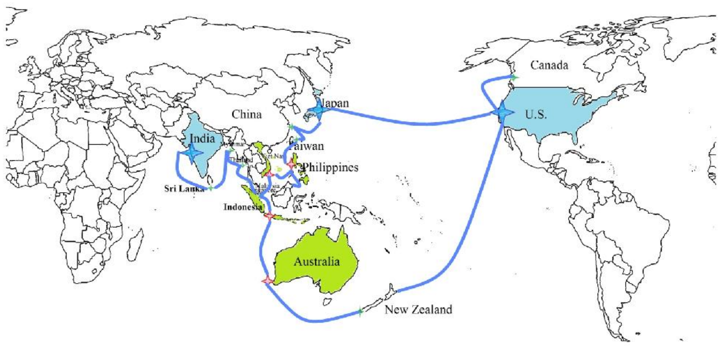
PAMEC



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Thanks for your attention!

Q&A

Questions or discussions can be sent to:
Email: nguyen.ducthanh@vepr.org.vn
Viet Nam Institute for Economic and Policy Research,
University of Economics and Business, Viet Nam National University
Room 707, Building E4, 144, Xuan Thuy, Cau Giay
Email: info@vepr.org.vn
Tel: 04.37547506 ext 714/ 0975608677
Fax: 04.37549921