The main objective for the Vietnamese economy in the coming years is to maintain macroeconomic stability and existing growth rate. In this paper, we try to analyze and estimate implementation of main goals to provide a panorama of the Vietnamese economy in 2010. We find that it recovered and regained momentum in 2010 but it still faces characteristic macroeconomic instabilities. By providing some predictions of its prospect from 2011 onwards and clarifying characteristics of its macroeconomic instabilities, we offer some policy suggestions that aim at improving the situation and accelerating a sustainable economic growth.

Keywords: inflation, trade gap, public debt, growth model

ECONOMIC GROWTH AND MACROECONOMIC STABILITY

AN ESTIMATE, PROSPECT, AND SOME POLICY SUGGESTIONS

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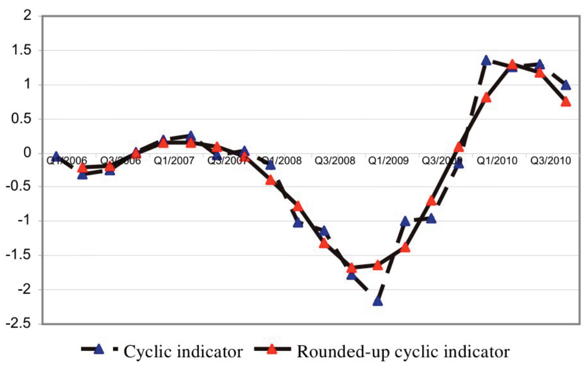
I. PANORAMA OF VIETNAMESE ECONOMY

1. Economic growth

While the global economy recovered slowly after its financial crisis, the Vietnamese economy soon escaped from recession. An analysis of economic cycles shows that it came into a period of recovery in 2010. Figure 1 provides indicators of economic cycles in 2006 – 2010. It recovery from a contracting period is marked with increasingly high growth rates in three successive quarters after passing its bottom point. It is an indicator of an expanding period in an economic cycle (Zhang and Zhuang; 2002). By this indicator, we see that the Vietnamese economy passed its contracting period with quarter I/2009 as its bottom point, started re-developing in the next three quarters of 2009 and regained a high growth rate in 2010.

Figure 1: Economic cycles 2006 – 2010



Source: GSO (2010) and authors' calculations

The Vietnamese economy in 2010 not only continued its 2009 recovery but also gained a pretty high growth rate in the context of global recession. Growth rate of the year in agricultural sector is estimated at 3% while this figure is 7.6% for

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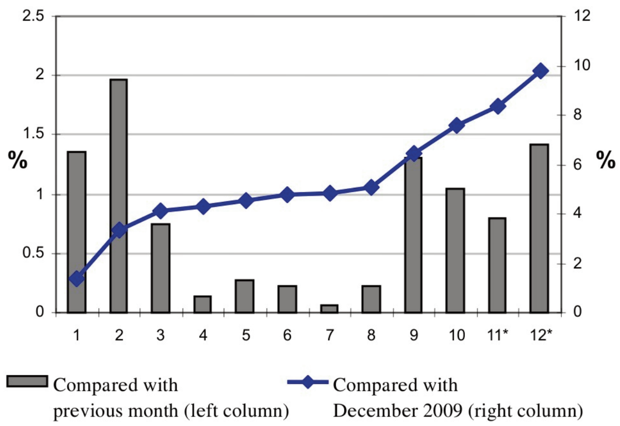
manufacturing and construction sector and 7.5% for service one. The GDP growth rate was 5.83% in the first quarter; 6.4% in the second one; and 7.16% in the third. the GDP growth rate in 2010, according to a rough estimate, is about 6.7%, higher than the planned target of 6.5% and much higher than the 2009 one (5.32%). This achievement makes the average growth rate of the period 2006 -2010 amount to 7% a year. Quality of economic growth, however, is still poor in spite of high growth rates because ICOR is on the increase (Đỗ Văn Huân; 2010). The highest ICOR is found in the public sector, which reduces efficiency of investment and quality of growth of the whole economy. Moreover, ratio of added value to industrial output kept falling from 0.62 in 2008 to 0.53 in 2009 and an estimated 0.43 in 2010. This proves that increase in added value does not match increase in scale of production and quality of economic growth has not been improved.

2. Inflation and market price

Curbing and controlling the inflation is central to Vietnam's macroeconomic stabilization in the past few years. Inflation in 2010, however, is still a "shadow" that follows the economic growth. When the growth rate has been rather high since the first quarter, CPI also increased again. The 2010 CPI is estimated at 10% (ADB, 2010a). Moreover, changes in CPI were not regular over months (see Figure 2). Average increase in the CPI in the first quarter was 1.35% per month. It rose by 1.96 percentage point in February in comparison with January. In the second quarter, its growth rate fell to 0.21% a month and rose to 0.53% a month in the third quarter. In September, it suddenly rose to 1.31% and fell to 1.05% in October (a high level in comparison with the same month in previous years). In previous years, market prices usually rises high in the first two months, and falls in March (after Tết Holiday), then rise slightly in the period from April to November and reaches its peak in December. Thus, regularity of changes in monthly CPI is broken in 2010. This means that the inflation is always unpredictable.

Figure 2: Inflation rate over months of 2010



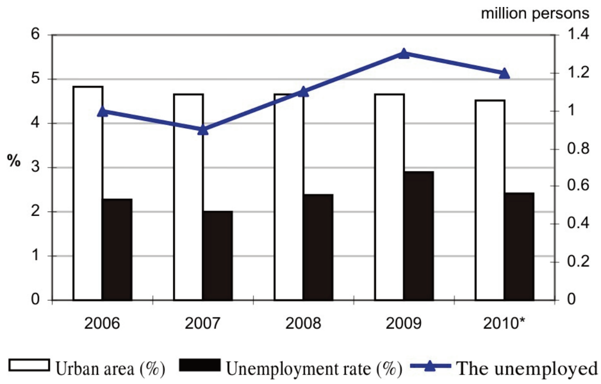
Source: GSO, Monthly socioeconomic reports (2010)

Inflation is the only indicator of 2010 that is below the planned target (7%). The high inflation rate partly came from a lag when implementing the demand stimulating package in 2009. In addition, higher public expenditure led to increases in the money supply although credit and total liquidity rose at a reasonable rate in 2010. Increases in prices on the domestic market are also affected by fluctuations in prices of raw material and food on international market. Depreciation of the domestic currency indirectly caused the CPI to rise when the gold price went high and became unpredictable. In such a complicated situation, keeping the inflation rate under a two-digit level is a success but not an easy task.

3. Supply of and demand for labor

The labor force in 2010 is estimated at 50.1 million from a working population of 56.37 million. Among them, 48.9 million got employed and 1.2 million were jobless (see Figure 3). Thus, the unemployment rate fell from 2.9% in 2009 to 2.4% in 2010. This rate in urban area was 4.52% comprising 0.82 million. These data show that the unemployed represent only a small percentage. However, casual unemployment rate was still high: 4.31% (this figure was 1.95% for urban area and 5.24% for rural one).

Figure 3: Unemployment in 2006 – 2010



Source: GSO (2010) and ADB (2010b)

According to a rough estimate, some 1.605 million new jobs were created in 2010 equaling the planned target. If the number of some one million of newcomers to the labor force in 2010 is taken into account, the number of new job created last year is higher. Over 1.7 million laborers took vocational training courses, which helped increase the percentage of trained laborers but these laborers only represent 40% of the labor force, according to the Government's report on socioeconomic development in 2010 and tasks for 2011 presented by PM Nguyễn Tấn Dũng at session 8 of the NA of 12th term, on Oct. 20, 2010. In other words, majority of laborers still do simple or manual jobs. This shows that training the human resource in technical skills is a matter of great urgency if Vietnam wants to improve the quality of its economic growth in future.

4. Trade balance

One encouraging result in 2010 is the fact that export value might reach US$69 billion increasing by 20.8% over 2009 (see Table 1) and nearly by three times compared with the plan. This achievement helps reduce trade gap to some 18% of export value in 2010and deficit in balance of payments to some US$4 billion, equal to some 50% of the 2009 deficit.

Import value in 2010 is estimated at US$81.5 billion increasing by 16.5% over 2009. From a positive aspect, increases in the import value are considered as good signs of an economy in its recovery period.

Table 1: Foreign trade and trade balance in 2006 - 2010

	2006	2007	2008	2009	2010*
Export (US$ billion)	39.8	48.6	62.7	57.1	69
- change (%)	22.7	21.9	29.1	-8.9	20.8
Import (US$ billion)	44.9	62.8	80.7	69.9	81.5
- change (%)	22.1	39.8	28.6	-13.3	16.5
Trade balance (US$ billion)	-5.1	-14.2	-18	-12.8	-12.5

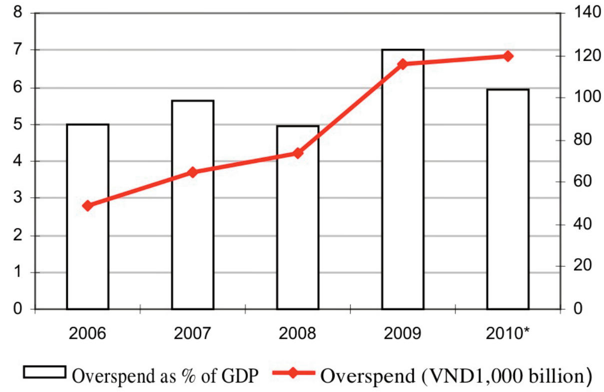
Source: GSO, Monthly socioeconomic reports (2010)

Although import increased more slowly than export, the 2010 trade gap only reduced by 2.3% compared with 2009. Moreover, although the trade gap was kept under 20% of export value and stayed below the safe limit, its absolute value of US$12.5 billion is still high. If re-export of gold and export of precious stone are not taken into account, the 2010 trade gap is larger than 22% of the export value. This is the main factor that makes the balance of payments on current account suffer a deficit equal to 10% of the GDP. This figure is worrying because a deficit equal to 8% of the GDP in the balance of payments on current account may cause negative effects on macroeconomic balances of a country (IMF, 1996).

5. National budget

Budget income in 2010 is estimated at VND512,100 billion; 12.7% higher than the planned target and increasing by 17.6% compared with 2009 income. Budget expenditure approximates VND636,197 billion; 9.3% higher than the planned target. In spite of increases in the budget income, which helped reduce budget overspend in 2010 to a level lower than the planned target of 6.2% of the GDP, the budget overspend is still estimated at 5.95% of the GDP (see Figure 4). Expenditure on development projects – the biggest expenditure – rose extremely high, by 15.5% compared with the planned target. That is why the budget overspend in 2010 was still high and might affect unfavorably the budget balance in years to come because the government kept pursuing a loose fiscal policy to facilitate the economic growth.

Figure 4: Budget overspend in 2006 – 2010



Source: Ministry of Finance (2010)

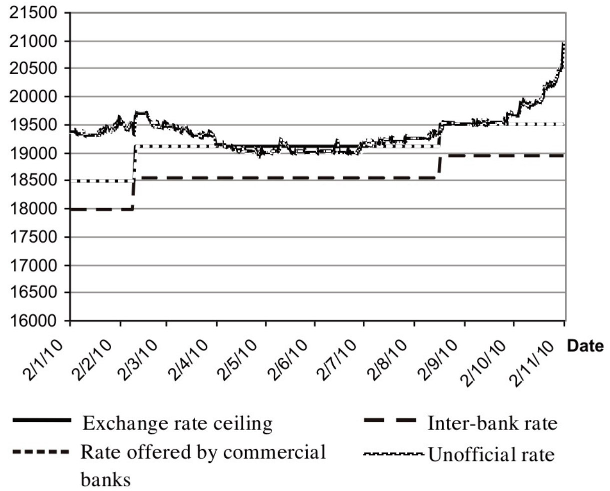
That budget overspend in 2010 made the national debt equal to 44.5% of the GDP, government foreign debt equal to 42.2% of the GDP and the public debt of the whole economy rose from 52.6% of the GDP in 2009 to 56.7% in 2010 (according to the above–mentioned Government's report on socioeconomic development in 2010 and tasks for 2011). Thus, the 2010 public debt is much higher than that of 2009 when the government had to increase the public expenditure to help the economy pass its recession. It is noteworthy that efficiency of the use of loans is considered as poor while possibility of secure long- and medium-term loans seems to reduce because Vietnam has been ranked among countries with medium income. Moreover, the public debt is nearing the acceptable limit (60% of the GDP according to Vietnamese standard). This means that national financial security is threatened.

6. Exchange rate and forex market

Stability of exchange rate is necessary to ensure macroeconomic stability and better inflation control. Changes in the exchange rate to the dollar in 2010 are presented in Figure 5. In the first quarter, difference between official and unofficial rates amounted to over VND200. On Feb. 10, 2010, a devaluation of 3.36% took place when the official rate moved from VND17,961 to 18,544 to the dollar. Pressure on the exchange rate reduced remarkably and the unofficial rate was even higher than the official one in the second half of the second quarter. This unusual phenomenon reflects a big difference between interest rates on loans in the VND and ones in the US dollar, which generated a great virtual supply on the market.

After staying at a level of VND19,000 to the dollar for two months (from early July to mid August) the unofficial rate started falling while the official one kept touching its ceiling. Facing this situation, the SBV devaluated the VND by 2.1% and the exchange rate to the dollar fell from VND18,544 to 18,932 as from Aug. 18, 2010. From mid-October onwards, however, the unofficial rate kept falling, to VND21,000 at times. Similar changes also took place in the official market where the official rate stayed at its ceiling of VND19,500.

Figure 5: Exchange rate to the dollar in 2010



Source: SBV (2010)

Sea changes in the exchange rate and adjustment by the SBV reflect tensions between supply and demand on the forex market. Since November 2010, the SBV has adjusted the official rate three times making it fall by 8.57% totally. The problem is that the exchange rate fell drastically when the US dollar was depreciated on the world market. Besides distortion of market forces caused by policy on exchange rate, this reverse movement is mainly from imbalance between supply of and demand for foreign exchange caused by high and prolonged trade gap, which produces an unfavorable balance of payments.

High increases in bank credit in the past few years also made the VND fall against the dollar. In addition, the VND has been also revaluated too much against the US dollar because in the years 2007-2009, the U.S. suffered an inflation rate of some 20% while Vietnamese inflation reached 42%. This situation also comes from high demand for loans in foreign exchange, dollarization and expectation of the public of a recovery of the US dollar. SBV decisions to lower the interest rate on loans in the VND also made value of the domestic currency fall remarkably, especially when the inflation control did not produce intended results.

II. PROSPECT OF VIETNAMESE ECONOMY FROM 2011 ONWARDS AND CHARACTERISTIC MACROECONOMIC INSTABILITIES

1. Prospect

Above analyses show that the Vietnamese economy passed its recession and came to a period of recovery in 2010. In 2011, it will enjoy positive effects from recovery of the world economy. Many indicators, according to predictions, will be improved remarkably in 2011 and the most noteworthy among them are increases in private investment and domestic spending (EIU, 2010; ADB, 2010c). In addition, export will grow considerably due to higher demand from foreign markets (ADB, 2010c); and capital inflow will increase and become stable when global finance and investors confidence are improved and beefed up (ADB, 2010c). These encouraging signs allow us to believe Vietnam will achieve a higher growth rate from 2011 onwards.

2. Characteristic macroeconomic instabilities

It is generally admitted that the Vietnamese economy still faces characteristic instabilities although it dealt successfully with many challenges in the recession and regained its growth rate in 2010. These instabilities not only hinder the economic growth in a short term but also erode its sustainable development in a medium term and reduce potentials for development in a long term.

Firstly, its inflation is high in comparison with regional and global averages in many successive years. With a high growth rate as its top priority, inflation control in Vietnam becomes very difficult. Increasingly high demand for credits and investments makes it impossible to keep the inflation rate at a low level. Vietnam, as a small economy with high openness, cannot prevent import of inflation when international market price keeps hiking and domestic currency keeps falling. High inflation rates in recent years affected by increased prices on the world market along with internal factors will cause negative effects on the market price in 2011. It is estimated that the Vietnamese economy in 2011 will be more stable and the inflation will be about 7% although it is very difficult to achieve this goal after the inflation was excessively controlled in 2010. High and prolonged inflation will certainly lead to disastrous consequences to local production and spending power.

Secondly, extremely high trade gap in recent years has damaged balance of payments on current account and balance of payments, reduced forex reserve and made the domestic currency depreciate. Domestic saving only equals some 27% of the GDP while gross investment equals 41% of the GDP (MPI, 2010). Huge difference between saving and investment leads to a huge deficit in current account in which the trade gap accounts for the best part. When the forex reserve is small, and public debt and inflation are high, prolonged trade gap along with huge deficit in the current account will make the domestic currency depreciate more seriously and produce negative effects on exchange rate and forex market. Regular devaluation, however, will damage public confidence in the domestic currency with the result that market prices and inflation rate will increase, which leads to more serious macroeconomic instability.

Thirdly, increased public debt in the context of huge budget deficit seems incurable. When the domestic saving can only account for a small share in the gross investment (difference between ratios of saving and of gross investment to the GDP amounts to 14 percentage points), Vietnam needs big sources of capital to ensure a high ratio of gross investment to the GDP. Beside foreign investment, the Vietnamese government should secure huge loans to cover this difference, therefore, increases in public investment will make Vietnam's public debt bigger in the coming years. This is an alarming fact because Vietnam's budget deficit has been higher than 5% of the GDP for years. As a result, ratio of public debt to the GDP may exceed the acceptable limit in a medium term and threaten national financial security.

These characteristic instabilities come from inherent weaknesses that have existed for years in the development model. Vietnam has pursued the model that relies on increases in inputs – especially increases in investments – while contributions from human resource and factor productivity are still low. Expanded credit supply and increased public investment force Vietnam to accept high inflation as a price for high growth rates. Poor human resource makes it difficult to develop supporting industries with the result that the local production depends too much on imported raw materials and capital goods. In addition, low productivity and internal accumulation of capital leads to a big difference between saving and investment, and the trade gap becomes inevitable.

Increased public investment in the public sector is scattered with a low efficiency, which makes budget deficit permanent and public debt extremely high. These factors may cause three macroeconomic instabilities (inflation, trade gap and public debt) in the coming year if consistent macroeconomic policies are not worked out. Thus, Vietnam should maintain its short-term economic growth and at the same time ensure macroeconomic stability to gain long-term development. In addition, the best way to achieve macroeconomic stability and better quality of growth is to adopt a new development model.

III. POLICY IMPLICATIONS

Vietnam should not follow the development model of old style that has produced characteristic instability because the economic growth in this model is temporary and unstable. In the coming years, Vietnam had better accept a growth rate of medium level with a view to gaining a macroeconomic stability needed for a long-term and sustainable development. In 2011 and the years to come, macroeconomic stability should be considered as the top priority. Economic growth should be maintained and at the same time, a new model of economic development should be adopted. Although characteristic macroeconomic instabilities come from internal shortcomings of the development model, adoption of a new model requires a long and continuous effort. With this argument, we think full attention should be paid to the following problems in 2011 and years to come.

Monetary policy should give priority first to inflation control and then support for economic growth. To achieve this aim, the money supply should be reasonable and flexible enough to keep inflation rate at a reasonable level, satisfy corporate demand for capital and total liquidity of the economy. Implementation of the monetary policy should be consistent in order to stabilize public mentality. For example, the nominal interest rate is based on mutual agreement and should be predictable when signs of inflation make their appearance. Consistency in implementation of policy, exact and transparent information, and sensibility and timeliness of changes in policy will produce trust in the market. Operations of the central bank should be separated from direct influence of the government, which can make the central bank get autonomy in setting forth policies, set clear goals, and operate more effectively in the effort to achieve macroeconomic stability.

The monetary policy cannot ensure the macroeconomic stability when fiscal policy is poorly controlled. This means that the fiscal policy should definitely aim at reducing budget deficit and public debt. Fiscal discipline should be beefed up. Namely, plans for budget incomes and expenditures should reflect the effort to cut budget deficit and public debt. Effective measures include reviewing all sources of incomes and expenditures, and rationalizing public investments (focusing on projects or fields with high feasibility and low investment lag with a view to maintaining the growth rate and reducing the budget deficit). Principle is that poor treatment of private sector when implementing the monetary policy should be limited. Moreover, public investment should produce a spillover effect to encourage investment from private and foreign sectors. In addition, the government should stop directing state-owned banks to supply loans to state-owned companies or guaranteeing foreign debts of state-owned companies, especially state-owned groups and corporations.

The year 2011 should be a starting point for a definite change in the development model when Vietnam implements its new 5-year plan (2011-2015) and 10-year development strategy (2011-2020). The definite change can help Vietnam solve the root cause of its macroeconomic instability. Process of changing the development model should aim at improving quality of the economic development and rely on four pillars: higher share of industries with high added value, development of supporting industries, replacement of technologies, and contraction of the public sector. A well-organized public sector, and bigger shares for private and foreign sectors, especially in development of infrastructure, will help reduce excessive public investment and improve quality of investment. This structure can bring about many benefits, such as reduced pressure of inflation and budget deficit, less risks from public debt, less imbalance between saving and investment, and smaller deficit in balance of current accounts. Along with the change in development model, Vietnam should deal with shortcomings in its human resource, infrastructure and institutions in 2011 and the years to come in order to tap it potentials and start taking off■

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