Problems with the CPI in Vietnam

by Dr. PHẠM QUỐC TRUNG

In Vietnam, the basket of goods and services used for calculating the CPI comprises 396 items divided into 10 groups of the class 1; 34 groups of the class 2 and 86 groups of the class 3 (and 32 out of 86 groups of the class 3 are divided into 75 groups of the class 4, or the basic class) Selection of these items for each provinces is carried out by the provincial bureaus of statistics.

According to the general rules, three investigations are carried out every month to record changes in prices on the 25th of the previous month and on the 5th and 15th of the reporting month. To reduce investigations, however, current regulations only require the record of prices of 92 items three times a month; prices of 286 items once a month and 14 items at any time when adjustments to their prices are made by central authorities.

The standard basket of goods and services differs over countries. The only aim is to gather the most possibly exact changes in the average price of all representative goods and services in order to provide an accurate basis for assessment of the inflation rate and economic analyses.

1. Recent changes in the Vietnamese CPI

Continuous and permanent change in the CPI is considered as normal. If these changes follow some cyclical pattern and have a reasonable band, the economy is considered as stable, otherwise it causes a lot of worries for policy makers and macro- economic authorities.

In Vietnam today, changes in the CPI raise a lot of interest and worries from the public. If rises in the CPI is high and beyond control, the economic crisis seems very near, which can lead to serious socioeconomic problems and poor growth rate. But solving problems caused by alarming changes in the CPI requires identification of their causes.

In the years 2000-03 when the economy recovered from the 1997 crisis, macroeconomic indicators changes reasonably, the growth rate stayed high (6.79% in 2000; 6.89% in 2001; 7.08% in 2002 and 7.26% in 2003) while the inflation rate was low and well under control (-0.6% in 2000; 0.8% in 2001; 4.0% in 2002 and 3.0% in 2003), the CPI changed according to a regular and normal pattern (it rises quickly in the fourth quarter, and slows down or stay stable in other quarters). These data show a promising and stable growth. After the 2003 Tết Festival, however, the CPI rose high and has kept staying high since, and showed an upward tendency.

In early 2004, high increases in the CPI could be considered as results of the spread of the bird flu which broke out before the Tết Festival and became widespread afterward. This explanation was reasonable and persuasive enough because other macroeconomic indicators at that time were still stable and the 2004 growth rate was still high (7.79%). The bird flu caused a shortage in the supply with the result that the price of poultry and the demand for other kinds of meat rose accordingly. Meanwhile, the transport cost rose by 3.1%; medicines and health care service by 1%; rice by 0.7%; and increases in household appliances and education service varies between 0.5% and 1.0%. All of these goods and services represent high shares in the standard basket (food 29.58%; household appliances 9.20%; health care 2.41%; and means of transport and postal service 10.07%, etc.). That is why high increases in the CPI in the first half of 2004 were inevitable.

In the second half of 2004, the CPI kept increasing when the new school year started, the dry season made the construction business more active, the wed-

Pho to by Huỳnh Thơ

ding season came along with other traditional festivals. These increases might produce positive effects because they reflected the rise in the market demand and spending power. In 2005, the CPI still had an upward tendency but its rise was relatively stable while the growth rate rose to 8.4%.

The public opinion, however, started expressing some worries when the CPI showed no sign of decline for a long time. Policy makers also thought of potential inflation and other dangers.

2. What have affected changes in the CPI

From late 2005 till now, many factors have produced direct and indirect effects on changes in the market prices with the result that the CPI experienced wide and unusual fluctuations. The following are main ones.

a. Internal factors

The most noticeable ones are the spread of various diseases in the animal husbandry business (bird flu, foot-and-mouth, PRRS, etc.) and natural disasters (storms and floods) in the years 2005-07. These factors not only reduced the supply of food but also increase the demand of food, household appliances, medicines, building materials, young animals, seeds and feed, etc. When the existing sources failed to meet the market demand, the CPI started rising at a high speed.

High growth rate of the stock market from late 2005 on, especially its hot development in 2006 and 2007, has made the money in circulation increase. The addition volume of money, especially in hands of successful investors in the stock market, was used for speculating in real estate or buying luxuries, which made prices of many consumer's goods skyrocket unreasonably (as seen the prices of real estates in the second quarter of 2007 and of imported cars in the first half of 2007). Moreover, the idle money, when changing hands in the stock market, led to imbalance between the supply of and demand for investments and a danger of inflation, which in its turn, caused the CPI to increase.

High growth rates in the years 2000-07 have helped improve the personal income and the market demand, which is also one of causes of the higher CPI. In recent years, annual adjustments to the base wage in the public sector has produced worries about higher inflation rates, which led to a situation in which prices of goods always rise along with raises in wages.

When the Government decides to hold international conferences and festivals, the public expenditure increases quickly within a sort period of time, and new business opportunities are open to both foreign and local investors. Changes in the gross investment, personal income and employment prospects have stimulated the market demand for capital and consumer's goods making the CPI to rise.

In short, internal factors have been the main causes of increases in the CPI in recent years. When Vietnam integrates more actively into the regional and international markets, however, it can't avoid effects from the outside.

b. External factors

The most noticeable factor is the rise in the oil price in recent years. It has kept breaking the record limit when the political and social life in regions that are leading suppliers of oil to the world market experienced disorder and war. Vietnam, like most countries, has to suffer inflation and higher CPI in recent years just because of this.

Because local sources can't meet the demand for capital goods, the value of imports to Vietnam is high in comparison with the GDP. Any fever in prices on the world market also leads to rises in the CPI. For example, the rise in the rice price in 2005 and 2005 made the local food price increase by 14.3% and 7.8% in those two years. Vietnam imports Chinese goods in large quantities every year and China is suffering from high inflation rates and increases in market prices, and as a result, the Vietnamese CPI also rises accordingly.

Foreign investment and consumer's goods to Vietnam have tended to increase since Vietnam's accession to the WTO, higher demand for foreign goods while the supply rises slower helped increase the market prices.

To control the rise in the CPI, authorities must take measures to stabilize prices of imported raw materials. An easy solution for the time being is to cut duties on these goods and beef up control over trading in these goods. In the long run, authorities must work out strategic predictions of changes in prices on the world market in order to provide a basis for necessary measures to put the prices on the local market well under control.

Financial and monetary policies must aim at regulating inflow and outflow of capital and foreign exchange and orienting banking and financial sectors towards stable rates of interest. It's unreasonable for banks to increase their deposit and lending rates when the market price shows an upward tendency as seen in recent months.

To raise the base wage is necessary but other measures should be taken to stabilize the market price, otherwise adjustments to the base wage are meaningless and only lead to wider fluctuations in the prices. ■