

PRESS CLIPPINGS

Publication: The Straits Times  
Date: 27 August 2008

VIETNAM'S ECONOMY

# Doomsayers may be proved wrong



BY BRUCE GALE  
SENIOR WRITER

ONCE the darling of investors, Vietnam has lost its lustre this year.

Double-digit inflation, a widening trade gap, a collapsed stock market and increasing concern about the banking sector's stability have prompted several credit rating agencies and investment banks to downgrade the country. A report by Aseambankers Research says "the worst-case scenario would be for Vietnam to suffer massive capital flight, triggering a balance of payments crisis, and go to the International Monetary Fund for help".

Some painful adjustments are certainly likely. The banking sector, for example, may be in for a shakeout. Even so, more recent developments suggest the doomsayers may be wrong.

Sentiment has been moving against the country since last November, when inflation reached double-digit levels and the government seemed reluctant to abandon pro-growth policies in favour of macroeconomic stability. The inflation rate reached 25 per cent in May.

At the same time, the trade deficit for the first five months of this year totalled US\$11.1 billion (S\$15.7 billion), close to the US\$12.4 billion chalked up for the whole of last year. This prompted speculation that the country could soon run out of reserves to defend its currency, leading to a sharp devaluation of the dong.

An increase in international food and energy prices this year combined with a global economic slowdown meant that a rise in inflation, coupled with a possible downturn in export growth, was probably inevitable. That said, many of the country's economic problems are homegrown.

Last year, for example, the economy struggled to digest US\$6 billion of foreign direct investment disbursements (equal to 8.4 per cent of gross domestic product) while the government held down the exchange rate to promote exports. The resulting monetary expansion was made worse by the rapid growth of domestic credit as newly established commercial banks competed for market share.

Loans, mostly to the real estate and security sectors, increased by 54 per cent last year. With credit expanding at such a phenomenal rate, it is likely that loan appraisal procedures in many banks were compromised, raising the possibility of a rise in bad debts.

Years of rapid economic expansion have also produced infrastructure bottlenecks - electricity shortages, congested roads and ports, skilled labour shortages - and raised the cost of doing business.

Meanwhile, double-digit inflation has prompted workers across the country to strike for higher pay. Wage demands were behind 300 labour strikes in the first quarter of this year.

Indeed, until very recently, the only factor that seemed to be helping the country's economic managers deal with the excess liquidity in the economy was the increasing reluctance of foreign investors to press ahead with approved projects as a result of various administrative and infrastructure bottlenecks.

Developments in more recent months, however, give cause for optimism. This is because the government has finally abandoned its pro-growth strategy in favour of macroeconomic stabilisation. The prime interest rate, for example, has been raised three times so far this year.

Commercial banks are also being reined in. The credit growth ceiling for the year now stands at 30 per cent. The amount of credit allocated to real estate and stocks has been restricted. Reserve requirements have been raised and the government recently required banks to buy central bank bills worth about US\$1.3 billion to mop up excess liquidity.

Such measures are beginning to have an impact. Month-on-month consumer price inflation last month rose by only 1.13 per cent, the lowest since October last year. The trade deficit also plummeted to US\$728 million in June and US\$800 million last month as official curbs on imports took effect. This compared to deficits of US\$3.2 billion and US\$1.9 billion in April and May, respectively.

In other words, the outlook for the Vietnamese economy has improved considerably in the past few months. Inflation should stabilise in the coming months before easing next year.

Once that happens, Vietnam may once again become a favoured destination of foreign investors.

bruceg@sph.com.sg