Country Report

Economic Research Department

June 2008

Contents

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Economy

June 2008

COUNTRY BACKGROUND

The Socialist Republic of Vietnam, a Southeast Asian economy on the Indochina peninsula bordered with China, Laos, Cambodia, and with an extensive coast line facing the South China sea, has a population of 85 million in 2007 with a per capital income of USD834, below the average of East Asia but still double that of low income countries. The majority of population is within the working age of between 15 and 64 years old. The country is endowed with rich natural resources and human capital. Some key social and economic development indicators such as infant mortality, life expectancy, and literacy ratio are above the average of the emerging East.

Selected Social and Demographic Indicators

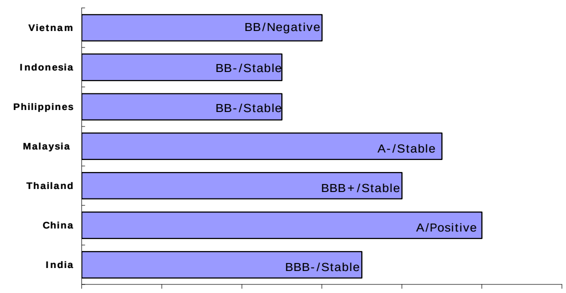
Indicator	(Unit of Measure)	1985	1993	2005	2006	*Memorandum items:* East Asia	*Memorandum items:* Low-Income Countries
GDP per capita	(U.S. dollars)	...	355	538	723	*914*	*432*
Infant mortality	(Per thousand live birth)	63	36	16	...	*34*	*80*
Population	(Millions)	60	69	83	84	*1823*	*2506*
Total fertility ratio	(Births per woman)	4.6	3.3	1.8	…	*2.1*	*3.5*
Age dependency ratio	(Ratio)	0.82	0.74	0.54	...	*0.50*	*0.70*
Life expectancy	(Years)	62	67	71	...	*69*	*59*
Energy consumption per capita	(Kg. of oil equivalent)	368	383	...	...	*871*	*569*
Net enrollment ratio: primary	(% of gross)	103	111	95	...	*106*	*92*
Net enrollment ratio: secondary	(% of gross)	43	36	76	...	*61*	*45*
Pupil-teacher ratio: primary	(Pupils per teacher)	34	35	22	...	...	...
Illiteracy	(% population age 15+)	11	9	...	...	*13*	*37*

Note: the numbers for East Asia and Low income countries are averaged ones.

Sources: IMF.

Vietnam's sovereign long-term foreign debt rating is BB with a negative outlook by the Standard and Poor's because of its current economic distress. The rating is one notch higher than both Indonesia and the Philippines, but still 2 notches below the investment grade. The country is ranked at 109 out 162 in the United Nations human development index, 77 out of 125 in Global Economic Forum's global competitiveness index, and 111 out of 163 in Transparency International's corruption perception index. Politically, Vietnam has been under one-party rule with a unicameral system since its reunification in 1975. It is reported that the ruling Communist intra-party democracy is progressing ahead and its National Assembly is gaining influences on the country's policy making process.

Standard & Poor's Long-term Foreign Currency Debt Rating



Source: Standard & Poor's.

Rapid economic developments in Vietnam are only a recent phenomenon. After gaining independence from the French colonial rule in 1954, the country was divided politically into the Communist North and the US-Backed South. It was soon engulfed into years of bitter fighting until a Communist victory in 1975. After the war, the economy stagnated under a planned, autarkic economic system from 1975 to 1985. It was not until 1986 when Vietnam began to open itself internationally under the *Doi Moi* (renovation) policy that the economy took off. Vietnam has since grown rapidly. Over the last decade, Vietnam grew at an average of 7.2%. The country's signings of the ASEAN Free Trade Agreement (AFTA) and the Bilateral Trade Agreement (BTA) with the United States in 2001 led to rapid growth in international trade. Trade growth has increased by 21% relative to the world average of 12% over the period of 2001 and 2007. Following an export-led growth strategy, Vietnam's economic growth over the last ten years was the second fastest in East Asia, only after China with high stability and low inflation. On 11 January 2007, Vietnam finally joined the World Trade Organization (WTO) as its 150th member.

GDP Growth and CPI Inflation: 10-year Average and Volatility (1996-2006)

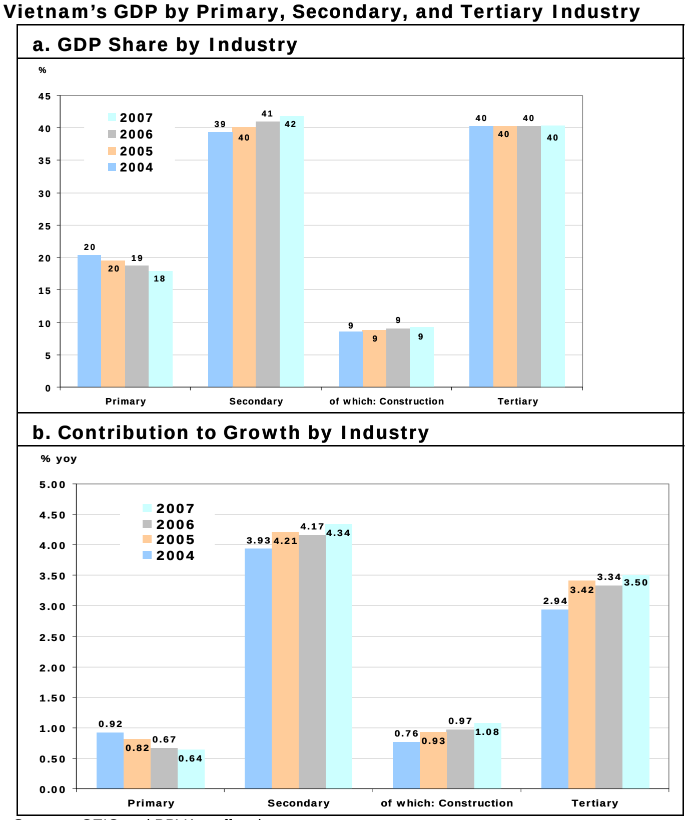
	GDP growth (% yoy)		CPI inflation (% yoy)	
	10-year average	Standard deviation	10-year average	Standard deviation
Vietnam	7.2	(1.2)	4.9	(3.7)
Indonesia	2.8	(5.8)	14.9	(15.9)
Philippines	4.4	(2.3)	5.6	(2.3)
Malaysia	4.3	(4.6)	2.4	(1.3)
Thailand	3.4	(5.1)	2.8	(2.3)
China	9.5	(1.5)	1.1	(2.0)
India	7.0	(2.0)	5.4	(2.9)

Sources: IMF and BBVA staff estimates.

ECONOMIC STRUCTURE

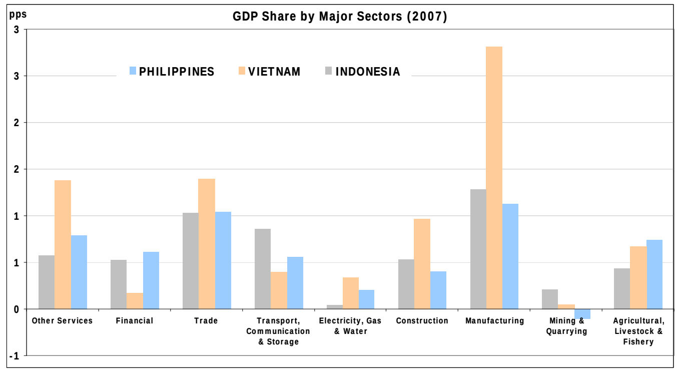
Similarly to other low-income emerging market economies, Vietnam's economic structure is dominated by primary (agriculture and fishery) and secondary (manufacturing sector) sectors with a combined share of more than 60% of GDP. The manufacturing sector is the fastest growing sector and it contributes to over half of the real GDP growth, while the tertiary sector contributes to about 40% of the real GDP growth, with the primary sector taking the rest. More specifically, manufacturing, trade, construction, and services are the driving sectors for fast economic growth.

Vietnam's GDP by Primary, Secondary, and Tertiary Industry



Sources: CEIC and BBVA staff estimates.

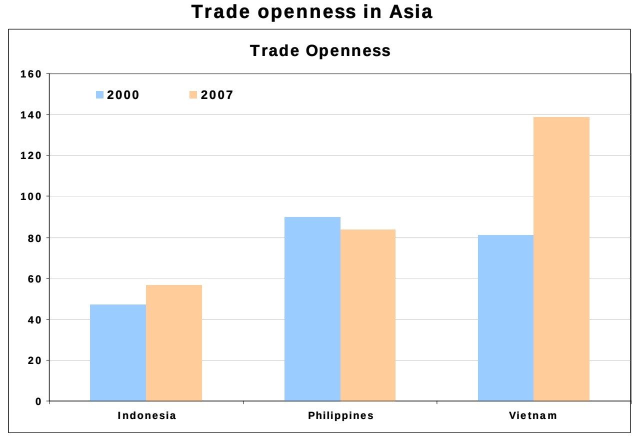
Contribution to GDP by Detailed Sectors



Source: CEIC and BBVA estimates.

Vietnam is a very open economy measured by the trade to GDP ratio. International trade as a share of the 2007 GDP was about 140%, much higher than that of the Philippines and Indonesia.

Trade openness in Asia



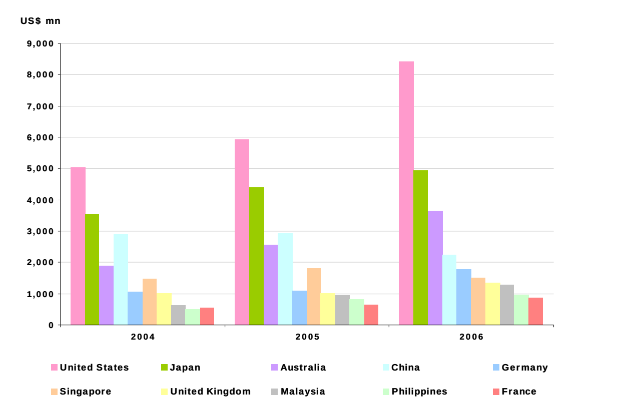
Source: CEIC and BBVA estimates.

The US is Vietnam's largest export market, absorbing about one fifth of its total exports and nearly a quarter of its non-oil merchandise exports. Other important export markets include the EU, Japan, Australia, China, and other ASEAN economies.

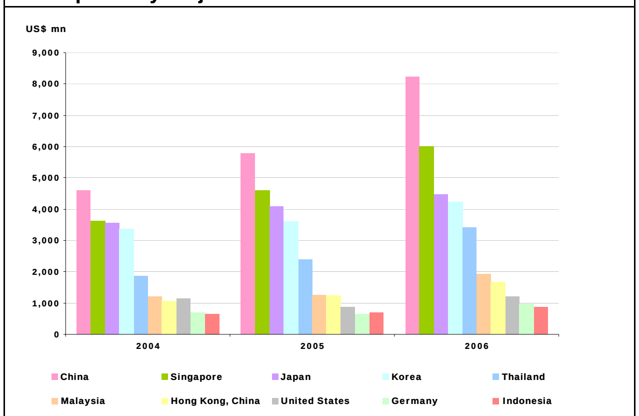
While ASEAN economies as a whole are the largest exporter to Vietnam, China is the single largest exporting country to Vietnam, with its share in total imports rising from 13% in 2004 to nearly 19% in 2007. In the third and fourth place of the major suppliers of Vietnam's imports are Japan and the EU.

Vietnam's Trade by Major Partners

a. Exports by Major Partners



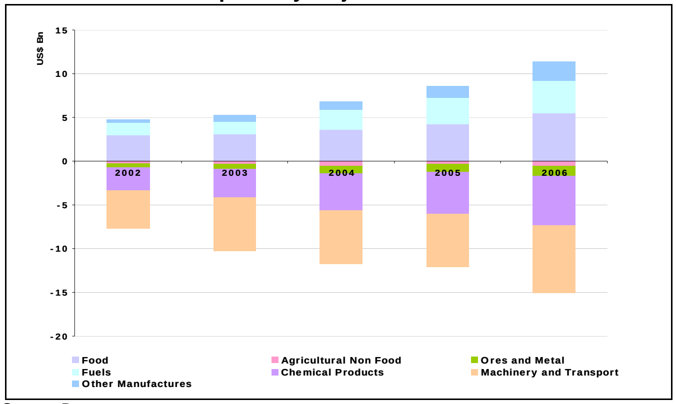
b. Imports by Major Partners



Source: Asian Development Bank.

Vietnam has traditionally been a relatively large exporter of crude oil, rice, and other agricultural commodities. With increased FDI in labor-intensive industries, Vietnam has recently emerged as a sizable player in light manufacturing products such as garments and footwear. Production capacity in these sectors has increased sharply in anticipation of its entry into the WTO. While Vietnam exports a lot of crude oil, it has to import a growing large amount of refined oil products such as gasoline and other chemical products. This will change soon as a new refinery facility with a daily capacity of 140,000 barrels per day is expected to start production by the end of 2008. The recent surge in FDI has also increased imports of machinery and equipment. It is expected that such imports will help spur export growth once they are absorbed in the productive capacity.

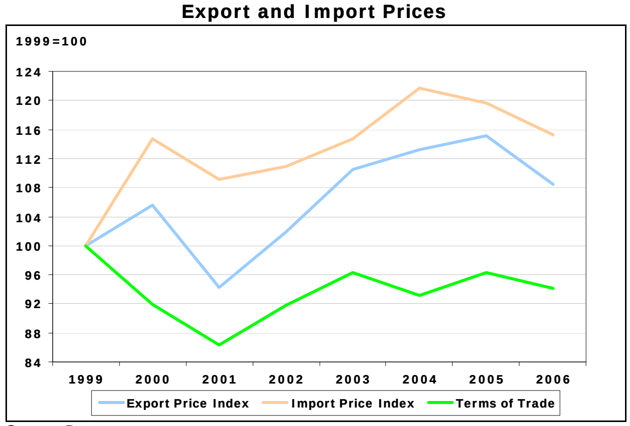
Net Exports by Major Products



Source: Datastream.

Increased FDI has been gradually transforming Vietnam's export structure and making its exports more sophisticated. Largely reflecting such improved sophistication and recent price increases in oil and agricultural commodities, Vietnam's terms of trade have experienced a slight improvement since 2001 from a sharp fall after 1999 followed by the severe economic downturn in ASEAN economies, falling commodities prices, and a sharp devaluation of the dong.

Export and Import Prices

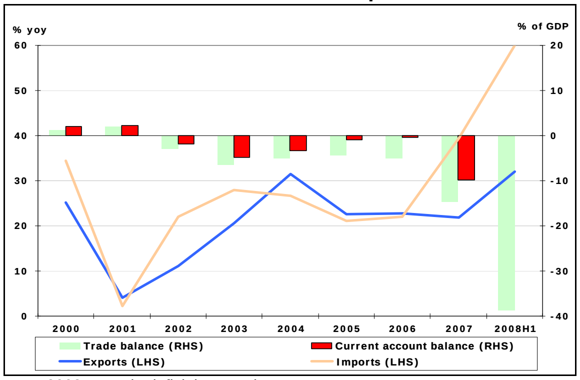


Source: Datastream.

After the sharp downturn in 2001, both export and import growth picked up strongly in 2002 with imports growing much faster than exports until 2004, when export growth exceeded import growth. This trend was reversed again in 2007 with import growth surged to 39.4%, while exports grew by over 22% in 2007.

Vietnam ran a small trade surplus until 2001. Its trade balance turned negative in 2002 and has since been running a sizable trade deficit of about 5% per year. In 2007, trade deficit worsened sharply to 15% of GDP. Preliminary estimates suggest that trade deficit worsened further in the first half of 2008 to close to 40% of GDP, with exports increasing by 32% while imports surged to 60%. Although the surge of imports was mainly driven by investment needs and was largely financed by FDI flows (9.4% of GDP in 2007), it nevertheless poses risk for the macroeconomic management and price stability.

Trade and current account balances and growth in exports and imports



Note: 2008H1 trade deficit is an estimate.
Sources: IMF, World Bank and BBVA staff estimates.

The persistent trade deficit for the period between 2002 and 2008 can be largely attributed to the savings and investment conditions in Vietnam and its trade structure and competitiveness. As a developing economy relying on foreign capital for investment in order to generate faster future economic growth, the country would have to borrow capital and, thus, run a capital account surplus and a current account deficit. The size of the current account deficit is often determined by domestic demand conditions and trade competitiveness.

Given the sharp surge of the current account deficit in 2007 and 2008, it raises serious question of external sustainability. A detailed breakdown of exports and imports that help illustrate this unsustainable pattern of trade in the last two years.

Total imports grew by 39.4 percent in 2007. Growth was especially high for imports of capital goods such as machinery and equipment, electronics and computers, and iron and steel, each rising by 68%, 45%, and 74%, respectively. In addition, consumption imports also increased rather rapidly. For example, automobiles and parts increased by 94% in 2007 and by over 300% in the first four months of 2008. Imports of refined oil products and chemicals also rose very fast, also reflecting a high price effect. Imports continued to rise in the first 4 months of 2008, reflecting both an expansion of domestic investment and demand (e.g. machinery equipment and automobile imports) and higher international prices in oils and commodities.

The relation between inward FDI and imports is, anyway, quite clear: imports by foreign invested companies increased by 47%, accounting for 30% of total purchases abroad, mostly in the category of machinery and equipment.[1] As inflation accelerated at the end of 2007 and in the first five months in 2008, massive imports of gold also contributed to the widening trade deficit. It was reported that in the first 4 months of 2008, 43 tons of gold were purchased abroad, for about USD1.2 billion.[2]

Vietnam: Import Structure and Growth

	Value (US$ million)	Year on year growth (percent)				
		2006	2007	4M-06	4M-07	4M-08
Total import value	62,682	21.4	39.4	6.9	32.8	71
Petroleum products	7,710	18.8	29.2	22.4	14	70.2
Machinery and equipment	11,123	25.5	67.8	14.2	52.7	47
Computer and Electronics	2,958	20	44.5	15.9	36.1	47.2
Pharmacuticals	703	9.2	28.3	24.8	23.9	17.9
Garment and leather materials	2,152	-14.5	10.3	-5.4	-5.4	16.3
Iron and Steel	5,112	0.2	74.1	-30.1	72.9	153.1
Fertilizers	1,000	5.9	45.5	5	45.7	165
Plastics	2,507	28.2	34.4	23.4	34.8	38.1
Fabrics	3,957	24.4	32.6	28.7	22.4	16.2
Chemical products	1,466	20.4	40.7	17.7	35.5	39.6
Chemical products	1,285	19.7	27.6	27.3	23.9	30.4
Automobiles and parts	1,881	-18.6	93.6	-54.9	-3.9	333.2
Yarns and fibers	741	60.2	36.3	31.3	43.2	28.7
Pesticides	383	25.3	25.4	25.3	27.8	52.4
Cotton	267	31	22.1	0.2	49.7	70.5
Paper	600	31.2	26.2	42.8	10.7	60.4
Other	18,835	40.4	27.3	3.1	34.5	85.5

Source: General Department of Customs and Government Statistic Office, Vietnam and World Bank

Vietnam: Export Structure and Growth

	Value (US$ million)	Year on year growth (percent)				
		2006	2007	4M-06	4M-07	4M-08
Total export value	48,561	22.8	21.9	25.1	22	27.6
Crude Oil	8,488	12.1	2.4	15.6	-10.5	46.2
Non-Oil	40,074	25.9	27.1	28	31.2	23.9
Rice	1,490	-9.3	16.8	-9	-7.3	72.7
Other Agriculutral Commoditie	4,696	42	31.3	34.4	49.7	6
Seafood	3,763	22.6	12.1	22.5	20.4	13.6
Coal	1,000	36.6	9.3	47.8	23.4	28
Garment	7,750	20.6	32.8	38.7	31.7	24.5
Footware	3,994	18.2	11.2	21.4	11	15.7
Electronics and Computers	2,154	19.7	26.1	23.7	27.5	33.9
Handicraft	825	10.9	30.9	10.8	21.6	8.6
Wood products	2,404	23.7	24.4	31.9	24.2	22.5
Other	11,996	38.7	37.6	32.9	47.1	30.5

Source: General Department of Customs and Government Statistic Office, Vietnam and World Bank

As for exports, they grew by 21.9% year on year in 2007 and rebounded to 27.6 % in the first 4 months of 2008 and to an estimated 32% for the first half of 2008, led by rapid growth of non-oil exports, although export value of crude oil also increased strongly because of high international oil prices. In particular, rice and agricultural commodities, garments, electronics and computers, and handicrafts enjoy higher growth rates.

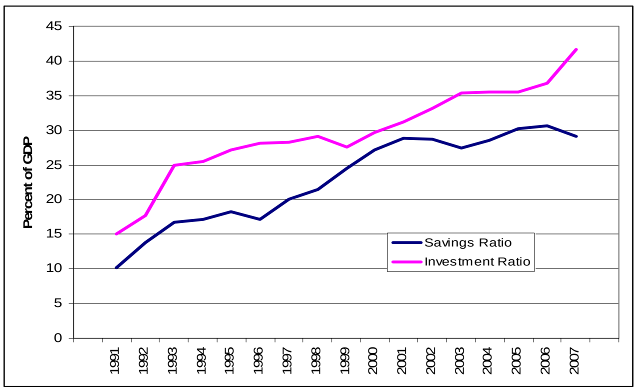
[1] See Taking Stock, World Bank, June 2008.

[2] As a part of stabilization package, the government has banned gold imports in June 2008.

VIETNAM'S MEDIUM TERM ECONOMIC POTENTIALS

The medium-term economic outlook of Vietnam remains promising supported by its high savings and investment ratio. The savings ratio as a share of GDP increased from roughly 10% in 1991 to close to 30% of GDP. High savings rate helps finance rapid investment growth, which took off from at 15% in 1991 to over 40% in 2007. This high investment growth has become increasingly unsustainable as the gap has to be met by foreign savings, thus leading to large current account deficit, at about 10% of GDP. While a large part of the current account deficit was funded by FDI, it remains risky should the prospect of the economy dims.

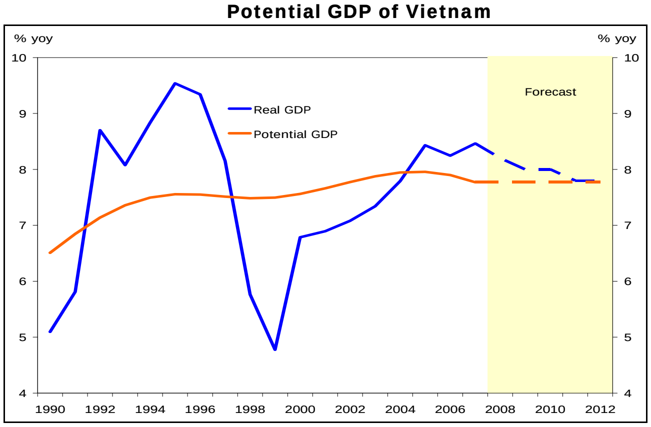
Savings and Investment Ratio in Vietnam



Source: CEIC.

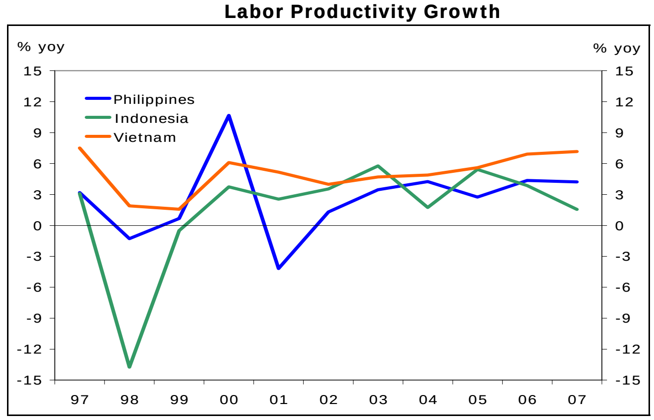
With high savings and investment rate, Vietnam has been maintaining a high economic growth rate at 7.2 over the last ten years. The country is projected to grow at close to 8% in the next five years by the IMF. Using an HP filter methodology, we estimate that the economy can grow at potential speed of 7.5% per annum.

Potential GDP of Vietnam



Indeed, Vietnam's positive medium-term growth prospects are also supported by its demographics, human capital quality, improvement of its institutional quality, and openness for trade. Vietnam's population structure is mostly within the working age from 15 to 65 years old with an average age at 26 years old. The fertility rate measured by birth per woman has declined to 1.8 relative to East Asian average of 2.1. The population is well educated with a primary and secondary education enrollment ratio at 95% and 76%, respectively, which is higher than the East Asian average and also higher than Indonesia and the Philippines. Meanwhile, labour productivity growth has been rising at 7 to 8 percent in recent years, which has been much higher than that of the Philippines and Indonesia.

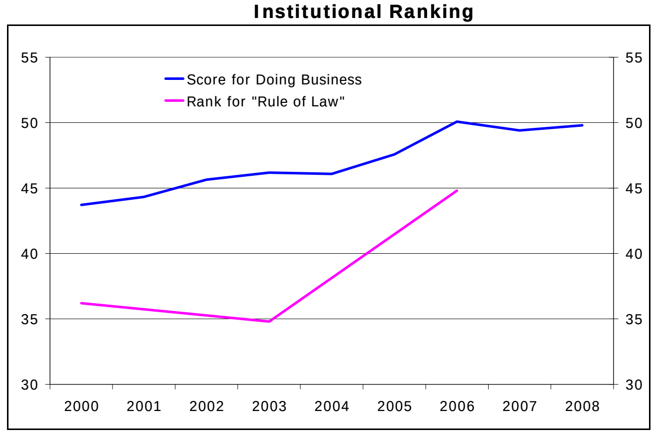
Labor Productivity Growth



Source: CEIC data and BBVA estimates.

As an effort to fulfill its WTO commitments, the government has been reforming its legal and other institutions to make them more compatible with international standards. Over the past several years, institutional ratings on rule of law and business environment have been improving steadily. The rule of law measure improved from around the mid 30s in 2000 to the mid 40s in 2006, while its business environment indicator improved from early 40s to 50.

Institutional Ranking

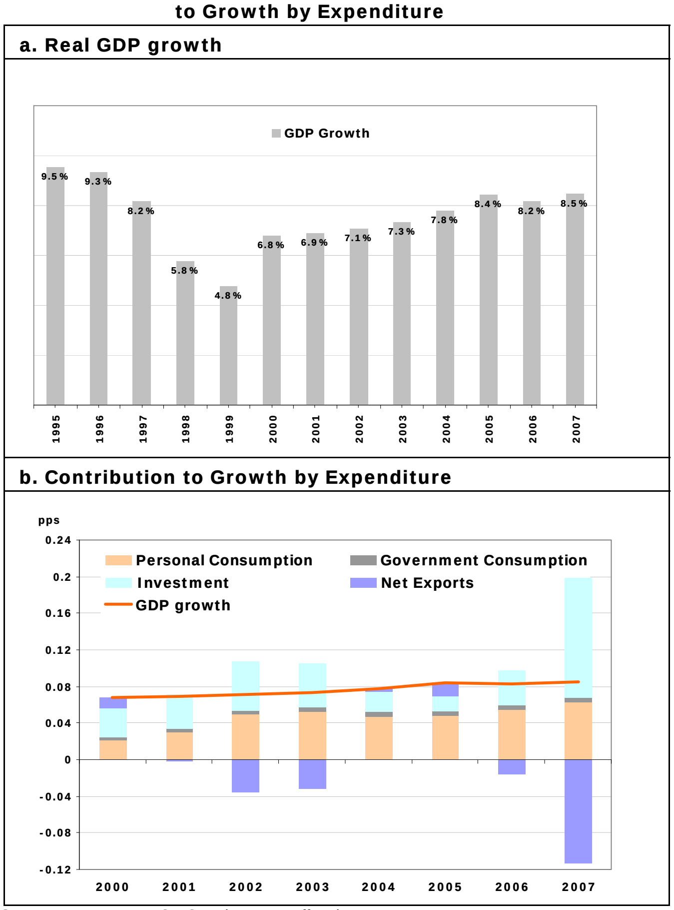


Source: World Governance Indicators (2007) and Doing Business Report (2008), World Bank

RECENT MACROECONOMIC DEVELOPMENTS

Real GDP growth recovered strongly and steadily after the Asian financial crisis from 4.8% in 1999 to 8.5% in 2007, led by robust growth in investment and private consumption. The economy had been on a fairly balanced growth path up to 2006. However, this path looked increasingly unsustainable in 2007 as current account deficit widened to close to 10% of GDP and investment growth surged to 40% of GDP in just one year. The Ministry of Planning and Investment reported 38,550 new business registrations in the nine months of 2007 with an invested capital 3.2 times higher than the same period last year, mainly fueled by large capital inflows. The negative contribution of net exports was roughly matched by the positive contribution of investment. In any event, their sheer sizes appear to be unsustainable.

Trend of Real GDP Growth and Contribution to Growth by Expenditure

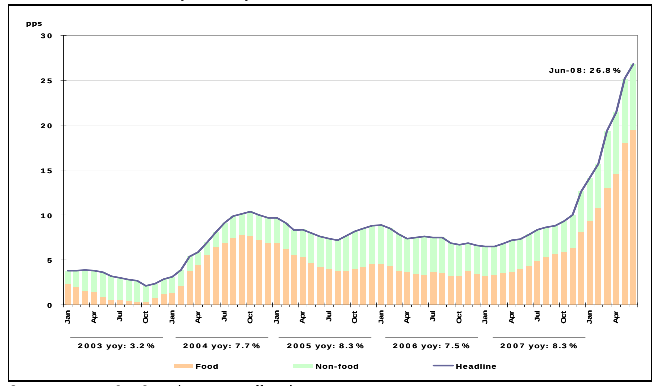


Sources: Datastream, CEIC and BBVA staff estimates.

Price stability:

Vietnam had bouts of hyper-inflation in the period of the early 1980s. This has changed for the better in the second half of the 1990s as its average inflation over the last ten years (1996-2006) was relatively low at 4.9% with relatively low volatility. CPI inflation started to exceed the ten year average and rose in 2004 reaching 7.7% year on year driven largely by rising food prices, while non-food price inflation also started to increase at a fast pace. Although year-on-year CPI inflation in 2007 was at 8.3%, monthly inflation had started to accelerate since October. It rose sharply in June 2008, reaching 26.8% year on year. The economy is obviously in a stage of overheating.

Headline, Food, and Non-Food CPI Inflation



Sources: IMF, CEIC and BBVA staff estimates.

Factors behind the Current Economic Overheating:

The current overheating of the Vietnamese economy can be attributed to a combination of factors such as large capital inflows, policy inactions and inconsistency, and some structural issues concerning the behavior of state-owned enterprises and joint stock banks.

Large capital inflows: Starting from 2006, international investors had become interested in Vietnam's economic potential because of its expected entry into the WTO, its track record in generating rapid economic growth, and its reform program to equitize (or privatize) state-owned enterprises (SOEs) and state-owned commercial banks (SOCBs). The WTO membership has not only expanded Vietnam's access to global market but also made its investment rules closer to international standards and, therefore, more predictable than before. Such changes in expectation have made Vietnam one of the most favorable FDI destinations. For example, the recent World Investment Prospect survey of the UNCTAD ranked Vietnam as the 6th most attractive location in the world by multi-national corporations.[3] The Asian Business Council also ranks Vietnam third in the world in terms of attractiveness for investment in 2007-2009.[4]

Vietnam was the largest recipient of FDI in 2007 measured by its share to GDP among emerging Asian economies, more than twice as large as that of China, the second highest among 5 Asian economies. FDI inflows rose sharply from USD1.76 billion in 2006 to USD6.56 billion in 2007, a rise of 3.7 times in just one year.

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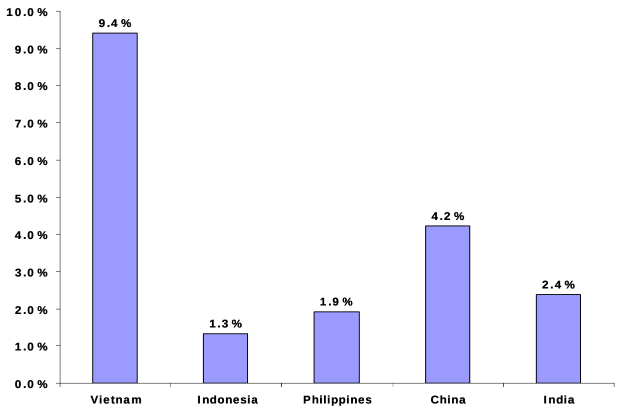
[3] See UNCTAD, World Investment Report, 2007.

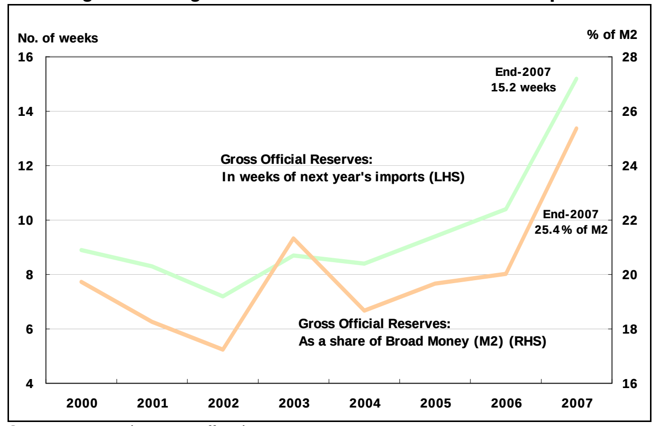
[4] See Asian Business Council (2006).

Foreign Direct Investment as a share of GDP (2007)



Source: IMF and BBVA estimates

Foreign Exchange Reserves relative to M2 and Imports



Sources: IMF and BBVA staff estimates.

Meanwhile, portfolio investment also started to flow massively into the country in 2007, reaching USD6.24 billion from a previous amount USD1.3 billion in 2006. Short-term loans, mostly intermediated by banks, with a maturity of less than one year jumped by 8.5 times, although from a very low base.

Because of large net capital inflows, Vietnam foreign exchange reserves reached USD23 billion, or 32% of GDP, by the end of 2007. Foreign exchange reserves currently cover 20% of broad money and about 4 months of imports. Although high for historical standards, this is still the lowest import coverage ratio among 7 Asian economies, including China, India, Korea, Malaysia, Thailand, Indonesia, and the Philippines.

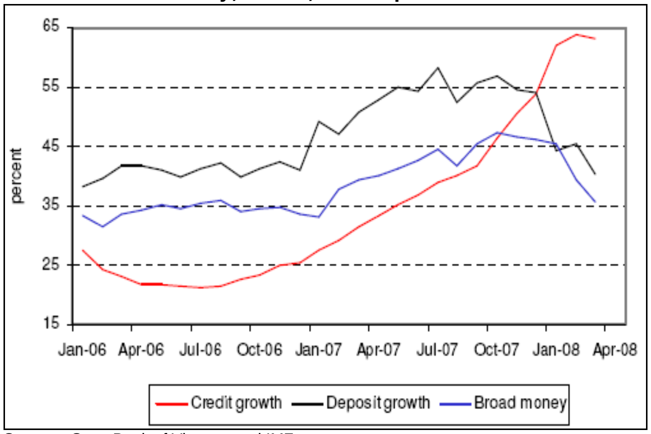
Summary of the Balance of Payments

	2003	2004	2005	2006	2007
A. Current account balance	-1,935	-1,565	-497	-164	-6,992
Trade balance (f.o.b.)	-2,582	-2,287	-2,439	-2,776	-10,360
Services	-778	-871	-219	-8	-894
Investment income	-814	-891	-1,219	-1,429	-2,168
Transfers	2,239	2,485	3,380	4,049	6,430
B. Capital account balance	4,086	2,447	2,628	4,486	17,540
FDI	1,304	1,342	1,430	1,757	6,550
Medium- and long-term loans	974	1,396	1,360	1,139	2,045
Short-term loans[1]	1,808	-291	-1,027	277	2,352
Portfolio investments	--	--	865	1,313	6,243
C. Change in international reserves (=A+B)	-2,151	-883	-2,131	-4,322	10,199

Sources: IMF and State Bank of Vietnam.

Inadequate Monetary policy response: Confronted with a surge of capital inflows in a period of about 12 months, the monetary authority, the State Bank of Vietnam (SBV), had been rather passive in responding to large capital inflows as the government still chose to give growth the top priority. Under a de facto fixed exchange rate system, the State Bank of Vietnam should have responded by fully sterilizing capital inflows. Instead, the monetary authority simply purchased a large amount of foreign currency from the banking system to prevent the appreciation of the Vietnam dong (VND). In turn, the SBV handed commercial banks with the equal amount of domestic currency at the fixed exchange rate. As a result, the volume of bank deposits increased rapidly so did the bank credit. On a year on year basis, bank deposit grew sharply starting from January 2007 at less than 45% to up to 60% in July 2007. Credit growth accelerated even more sharply from 25% year on year in January 2007 to close to 65% in February 2008. Broad money also rose sharply from 35% year on year in January 2007 to over 45% in October 2007.

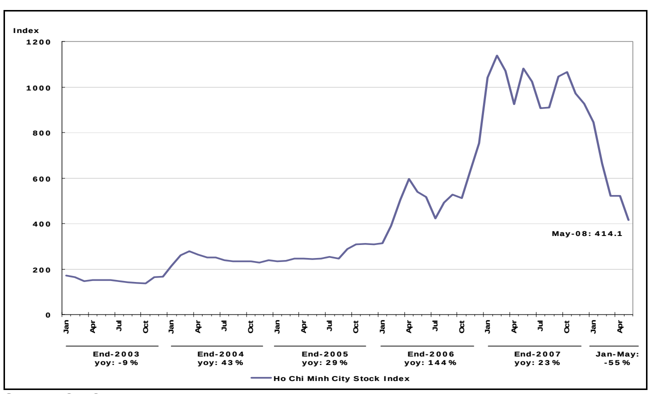
Broad Money, Credit, and Deposit Growth



Sources: State Bank of Vietnam and IMF.

Rapid credit growth also fueled a surge in both stock market and real estate prices. Other than foreign investors, domestic residents also started to shift from their domestic savings to the stock market and real estate, pushing equity and property prices even higher. However, since the beginning of 2008 the market sentiment has turned very negative, reflecting Vietnam's vulnerability to the global slowdown due to its high trade openness and its large current account deficit. The stock index fell by close to 60%, bringing the market back the level of January 2006.

Stock market prices



Source: CEIC.

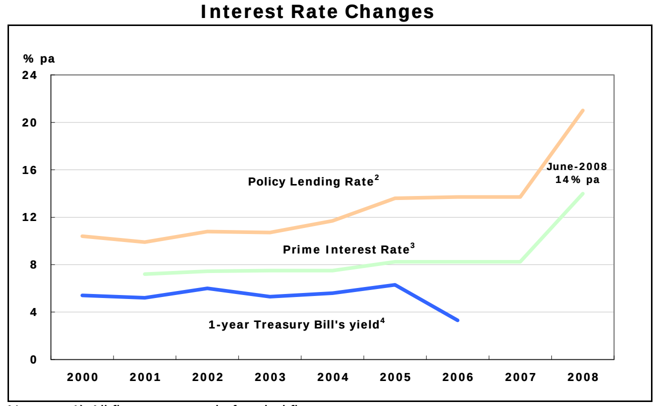
USD6.243 portfolio investment flew into the country; this implied that over 22% of the shares are in the hand of foreign investors. By this measure, the Vietnamese stock market is quite open for foreign portfolio investment, a sharp contrast from the Chinese market, which is mostly dominated by small and domestic investors. This fact also suggests that Vietnam has a relatively open capital account on portfolio capital inflows. Meanwhile, foreign investors do not face many impediments to repatriate their profits or withdraw their funds from the share market, either.

Policy Responses and Implementations so far: The government was too slow in responding to economic overheating and rising inflation. The SBV has tried to defend a de facto pegged exchange rate under a relatively open capital account which implies no independent monetary policy. Over the time, the SBV tried other means to control credit growth by selling SBV bills, raising the reserve requirement ratio and the policy interest rates. It even also widened the trading band of the foreign exchange rate to ± 1 percent (and more recently to two percent). None of these measures proved successful in reining in rapid money and credit growth.

Only in February 2008 did the government decide to sacrifice its growth target to fight inflation. Under the advice of the international financial organizations including the IMF, the World Bank, and the ADB, the government adopted a comprehensive stabilization program, which includes the following ingredients:

- On GDP growth target, the government has lowered the GDP target from 8.5 to 9 percent in 2008 to 7 percent.
- On credit policy, the government sold 20.3 trillion dong in compulsory bonds to commercial banks on March 17. This policy is similar to a rise of required reserve ratio, except the interest rate paid was higher. The government also announced to bring down credit growth to 30 in 2008.
- On interest rate policy, on 19 May the benchmark interest rate was hiked from 8.75 to 12 percent, thus lifting the maximum lending rate to 18 percent or 150 percent of the benchmark rate under the current maximum upward ceiling of the lending rate. On 11 June the benchmark interest rate was raised again from 12 percent to 14, thus lifting the maximum lending rate to 21 percent.

Interest Rate Changes

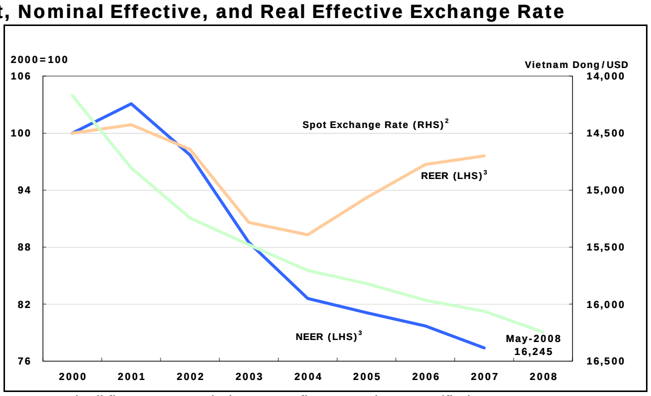


Note: 1) All figures are end of period figures.
2) The policy lending rate and prime interest rate both June 2008.
3) 1-year treasury bills yield is Dec-2006.
Sources: IMF and CEIC.

- On the exchange rate policy, on 11 June, the SBV announced that the VND would be devalued by

2% against the USD. While competitiveness reasons explain the move, it is also true that devaluing the dong may make inflation and trade deficits even worse. On 27 June, the trading band was increased to ±2 percent.

Spot, Nominal Effective, and Real Effective Exchange Rate



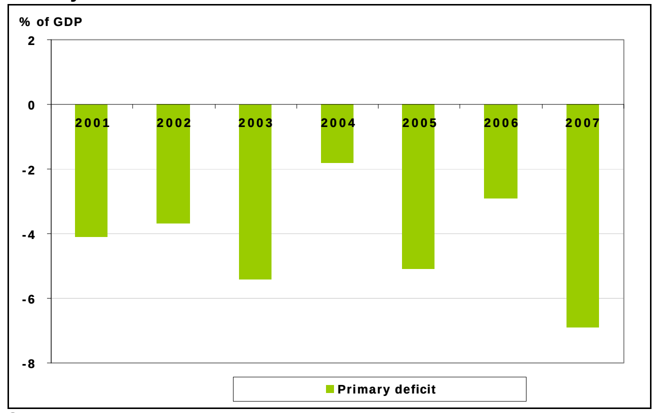
Notes: 1) All figures are period-average figures, unless specified.
2) In reverse scale, where the higher number means the depreciation of Vietnam Dong. The 2008 figure is end-May figure.
3) The 2007 figures of NEER and REER are Jun figures.
Sources: IMF and CEIC.

- On fiscal policy, the government has initiated a variety of program to stop 995 projects with 3.983 trillion dong in state funding, equivalent to 7.8% of the total investment budget. Further spending cut of 9 trillion dong or equivalent of 25% of the original plan is approved and a 10% cut in non-salary items was mandated for the last 8 months of 2008 with 2.7 trillion dong in savings. In total, these spending cuts are equivalent to about 1.5% of 2007 GDP. The stoppage of these projects will also help reduce imports.

WILL VIETNAM RUN INTO A BALANCE OF PAYMENT CRISIS? AN ASSESSMENT

With large spending cuts of 1.5% of the 2007 GDP, the government's stabilization package seems quite credible. The slowdown of investment growth will help cool domestic demand, thus reducing imports and dampening inflationary expectation. It is also useful for the government to bring down the primary deficit, as it is already very high at about 7% of GDP.

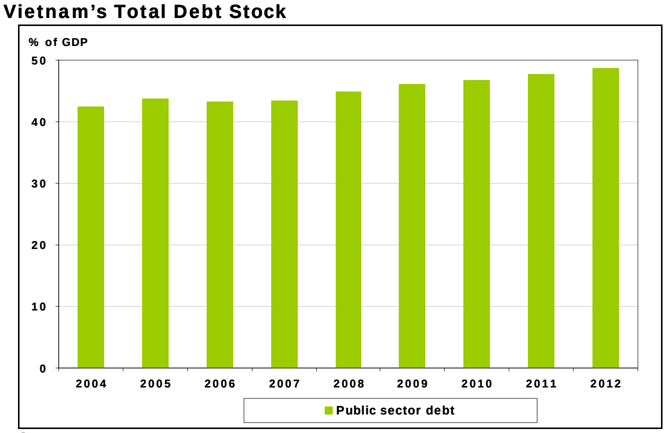
Primary Deficit as a share of GDP



Source: IMF.

The fiscal problem looks even worse if one considers the relatively high level of public debt as a percentage of GDP. Furthermore, public debt has not stabilized but grown during the last few years. This is a striking difference with most countries in the region. A recent joint study by the IMF and World Bank suggests that Vietnam does not have an external debt sustainability problem. However, if adding its domestic debt to the external debt stock, Vietnam fiscal sustainability may be at risk when the economy experiences a prolonged period low economic growth (IMF, 2007),

Vietnam's Total Debt Stock



Source: IMF.

It appears that as long as the government can implement the policy package, the probability that Vietnam runs into a balance of payment crisis remains low for the following reasons:

- *First, Vietnam's FX reserves are sufficient to cover portfolio and short-term debt:* Although there is limited data, portfolio outflows probably have already started as indicated by over 60% fall of the stock market. As shown by the balance of payment statistics, foreign exchange reserves (at USD23 billion at the end of 2007) are enough to cover portfolio outflows and short-term debt. However, a higher risk would come from FDI pulling out facilitated by the ease of profit repatriation or from a draught of FDI in 2008 (which seems less likely).

- Even if Vietnam were to run out of reserves (which could be due to the opaqueness of its statistics), Vietnam will also have an option going to its big neighbor in the North, China, which has plenty of reserves and is probably more willing to help out its remaining Communist brothers. In fact, on May 25, the Communist Party general secretary of Vietnam visited Beijing. The Hong Kong media speculated that the trip may be related to the economic crisis in Vietnam. From the economic point of view, China should also be willing to bail out Vietnam if needed for the following reasons: First, China is Vietnam's largest single supplier of imports. A severe economic disruption would have some negative impact on Chinese exporters, though relatively small given the size of total Chinese trade. Second, China does not want to see problems in Vietnam spreading to the rest of the region, which would eventually affect itself. In addition to the Chinese option, Vietnam has means to tap the multilateralized Chiang Mai Initiative, which has a war chest of USD80 billion. Given the traumatic experiences of the Asian financial crisis, the last option perhaps is for Vietnam to go to the IMF. Should Vietnam run into a liquidity crisis due to a sudden and large capital outflows, it looks like the crisis could be contained early on before it becomes worse.

- *Second, the banking sector risk will increase but a systemic crisis is less likely.* The stabilization program will certainly hurt SOE profits and therefore will probably increase non-performing loans in the banking system. Given the relatively large real estate exposure in some joint stock commercial banks (JSCBs), a sharp fall in the real estate prices, together with much tightened monetary policy, may lead to serious bad loan problem in certain JSCBs and may force some of them to go under. Because of the banking system is still largely owned by the state, a systemic bank run looks less unlikely at this moment. However, the potential write-offs will certainly increase domestic debt, which is already high relative to other countries in the region.

- *Third, the expected banking sector distress due to certain financial institution failures will certainly affect Vietnam's fiscal health, but the scale and scope of the problem may not significantly affect its debt sustainability in the medium term.* Indeed, how the government handles the resolution of financial institution failures will affect the size of the fiscal costs incurred. If the government allow some banks to fail, merge and consolidate with others and encourage foreign participation by raising the foreign ownership ceiling and selling assets at realistic prices, the expected fiscal costs may not affect the path of debt sustainability in a significant way.

In conclusion, it appears that Vietnam has a high probability to weather through the current economic storm contingent on firm implementation of the stabilization measures. If it does, the current stabilization program may be akin to some episodes of Chinese high inflation experiences in the early 1990s, that is, economic growth may experience a stop-and-go process and some banks may fail, but no serious crisis would occur.

In certain aspects, Vietnam is also quite different because its economy is more open than China in the early 1990s and it also has a very open capital account. If dollarization becomes a serious problem, the FX reserves can run out quickly. Though plausible, this scenario also has a low probability to occur because of the ownership of the banking system is still within the hand of the government. The government still has effective means to prevent dollarization though the control of the amount of dollar holdings by residents.

In any event, should the current economic stress deteriorates further, it will be a good opportunity for foreign investors to step in as the valuations in banks and firms become attractive relative to their long-term potentials.

Indicators of External Vulnerability

	2003	2004	2005	2006	2007[1]
Financial indicators					
Total external debt (% of GDP)	33.7	33.5	32.2	30.2	30.8
Broad money (M2: % yoy)	24.9	29.5	29.7	33.6	36
Credit to the economy (annual percentage change)	28.4	41.6	31.7	25.4	29
Foreign currency loans to credit to the economy (%)	22	24.9	24.3	21.1	...
Foreign currency deposits in percent of gross official reserves	110.7	130.1	104.5	108	...
External indicators					
Exports value growth (%)	20.6	31.4	22.5	22.7	17.2
Imports value growth (%)	28	26.6	21.2	22.1.	21.4
Current account balance (% of GDP, including official transfers)	-4.9	-3.4	-0.9	-0.3	-3.2
Capital account balance (in US$ million)	4,086	2,447	2,628	4,486	10,647
Of which:					
Short-term capital (net)	1,808	-291	-1,027	277	1,550
Gross foreign direct investment (inflows)	1,894	1,878	1,954	2,400	2,832
Medium-and long-term loans (net)	974	1,396	1,360	1,139	1,458
Exchange rate (per U.S. dollar, period average)	15,479	15,705	15,819	15,965	...
(annual percentage change)	-1.5	-1.5	-0.7	-0.9	...
Exchange rate (dong per U.S. dollar, end of period)	15,608	15,739	15,875	16,091	...
(annual percentage change)	-1.6	-0.8	-0.9	-1.4	...
Real effective exchange rate (end of period, % yoy, + appreciation)	-9.0	1.1	13.0	-2.8	...
Reserve indicators					
Gross official reserves, including gold (in US$ billion)	5.6	6.3	8.6	11.5	19.9
(in weeks of next year's imports of goods and nonfactor services)	8.7	8.4	9.4	10.4	15.2
Net official international reserves (in US$ billion)	4.7	5.6	7.7	10.3	...
Debt indicators					
Total external debt (in US$ billion)	13.4	15.3	17.1	18.4	21.3
Total debt service to exports of goods and services (%)	7.8	6.0	5.6	5.3	5.5
Of which: External interest payments to exports of goods and services (%)	1.2	1.0	1.2	1.2	1.3
Total short-term external debt by remaining maturity (in US$ billion)	1.5	1.5	1.6	1.8	2.2
Total short-term external debt by remaining maturity to total debt (%)	11.6	9.9	9.4	9.9	10.2

Note: 1) 2007 figures are IMF projections.
Sources: IMF.

EVOLUTION OF THE BANKING SYSTEM AND THE BANKING SECTOR STRUCTURE

After evolving from a monobank system to a two-tier banking system in 1988 that formally separated the functions of central bank from those of the commercial banks, Vietnam created four state-owned commercial banks with each SOCB originally specialized in a particular area of finance: Bank of Foreign Trade (Vietcombank) to finance external trade, Industrial and Commercial Bank (Incombank) to fund industrial Development, Bank for Investment and Development (BIDV) to facilitate infrastructure projects, and the Vietnam Bank for Agriculture and Rural Development (Agribank) to provide rural finance and support to commodities markets. A new SOCB, the Mekong Housing Bank (MHB), was set up in 1997 to support housing and infrastructure development in the Mekong Delta region and it has since become a bank with a national reach. In 1991, the government opened its banking sector for limited foreign competition and allowed more entry into the banking system with the establishment of joint-stock commercial banks (JSCBs), which have a more diversified ownership structure that consists of shareholders from the state and local government, state-owned enterprises, and private sector firms or entities. Their clients are mostly small and medium enterprises and individuals although, in search for growth and market shares, they have recently started to lend more to SOEs. JSCBs soon mushroomed and then experienced a period of consolidation. Presently, Vietnam's banking system consists of 5 state-owned commercial banks (SOCBs), one policy bank, 40 joint stock banks, 5 joint venture banks, 31 foreign bank branches, credit cooperatives and various non-bank financial institutions such as finance and leasing companies.

Banks and Non-Banking Credit Institutions in Vietnam (2008)

	Type of credit institution in Vietnam	Number
1	State Owned Commercial Bank (SOCB)	5
2	Vietnam Social Policy Bank (VSPB)	1
3	Joint Stock Commercial Bank (JSCB)	40
4	Joint Venture Bank (JVB)	5
5	Foreign Bank Branch	39
6	Finance Company	6 (5 belong to State General Corporations)
7	Finance Leasing Company	11 (6 are affiliates of SOCBs)
8	People's Credit Funds (PCFs)	Central People Credit Fund (24 branches) + 926 Local credit funds

Note: Foreign bank branch does not include JV banks.

Source: Merrill Lynch(2008).

The banking system used to be dominated by the five SOCBs. However, their dominance has waned somewhat in recent years. Their share of bank deposits has reduced from over 70% of the banking deposits to 59% in 2008. In addition, their lending to the state-owned companies (SOEs) has also reduced sharply to about 30% today. At the same time, joint-stock banks (JSBs) are gaining market share at a very rapid pace, reaching 30% of total deposits in 2007, compared to 21% just one year before. Foreign branches and joint-ventures hold roughly 8 to 10% market share in deposits, while the small credit and leasing institutions together account for less than 2% of the market share in deposits. Market share in lending roughly goes in line with the deposit structure.

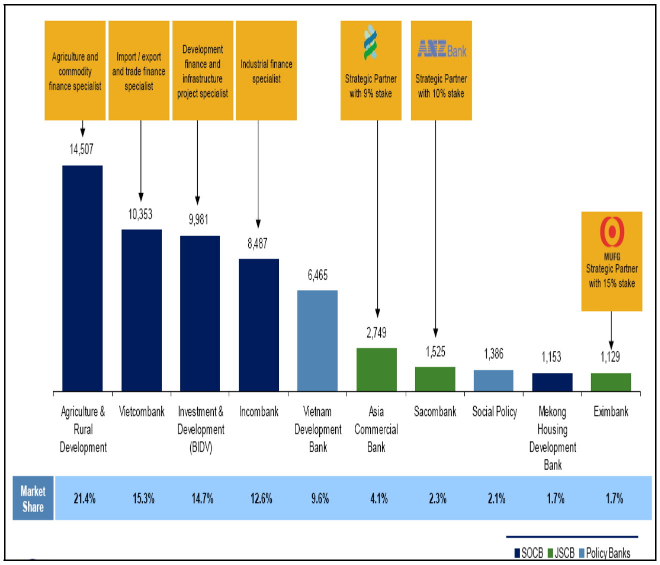
Market Share of the Credit Institutions in Vietnam (%)

	2000	2001	2002	2003	2004	2005	2006	2007
Market share in deposits								
State owned commercial banks	77.0	80.1	79.3	78.1	75.2	74.7	68.8	59.3
Joint stock commercial banks	11.3	9.1	10.1	11.2	13.3	15.7	21.8	30.4
Foreign bank branches + JVBs	10.3	10.0	9.4	9.3	9.7	8.0	8.1	8.8
PCFs	1.0	0.8	1.1	1.1	1.0	1.0	1.0	1.0
Others	0.4	0.0	0.1	0.3	0.8	0.6	0.3	0.5
Market share in lending								
State owned commercial banks	76.7	79	79.9	78.6	76.9	73	64.5	55.1
Joint stock commercial banks	9.2	9.3	9.5	10.8	11.6	15	21.2	28.6
Foreign bank branches + JVBs	12.4	10.4	8.8	8.9	9.5	9.6	9.3	9
PCFs	1.4	1.2	1.7	1.5	1.4	1.5	1.4	1.3
Others	0.3	0.1	0.1	0.2	0.6	0.9	3.6	6

Source: The SBV and Vo and Pham (2008).

With respect to the size of asset and out of SOCBs, the Agribank is the largest SOCB, followed by Vietcombank, BIDV, Incombank, and Vietnam Development Bank. The MHB has the smallest asset size among these SOCBs and policy banks. Within the ranks of joint-venture banks, the Asia Commercial Bank has a largest asset, follow by Sacombank and Eximbank.

Bank Ranking by Asset Size

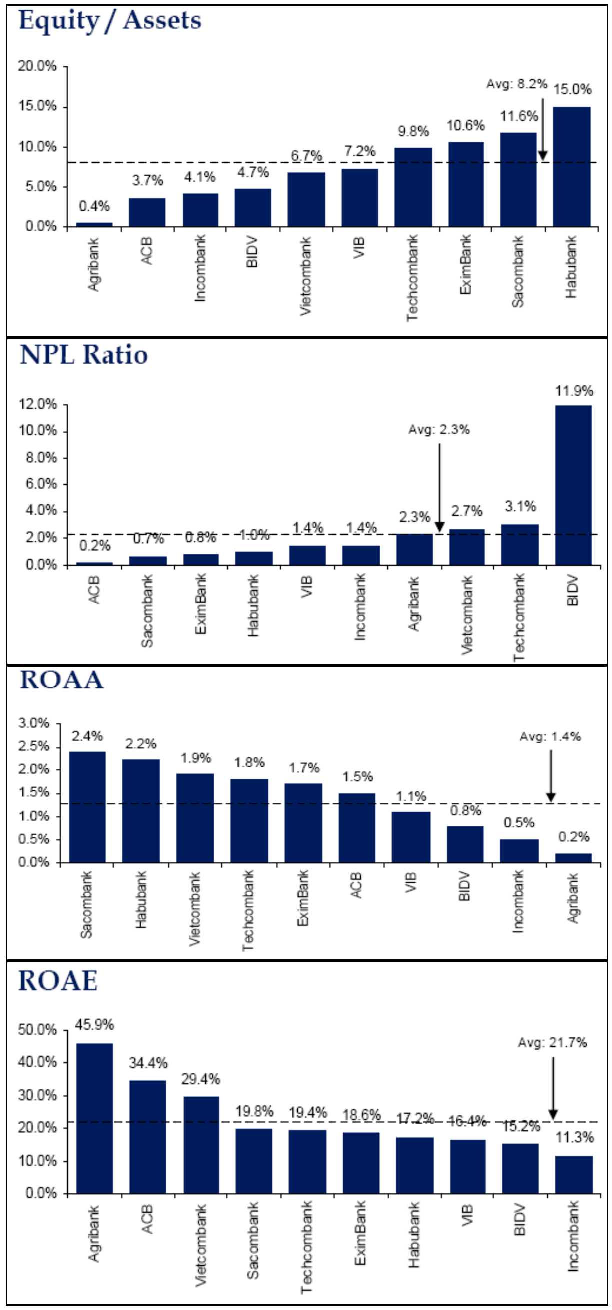


Source: Merrill Lynch (2008)

BANKING SECTOR PROFITABLITY AND PERFORMANCE

The latest estimates using official data suggest that the average capital of Vietnam's banks appear to be adequate at 8.2%. However, some large SOCBs such as BIDV, Vietcomebank, and particularly Agribank have yet to meet the minimum capital adequacy standard; this also applies to some large JSCBs. Although the banking system as a whole has relatively low NPLs at 2.3% of total assets, some large SOCBs, especially BIDV, have large amount of NPLs. According to the World Bank, however, the estimated NPLs for the banking system as a whole are much higher at 15% of total assets and are even higher if using International Accounting Standard. Given the latest round of rapid credit expansion, the NPLs in the banking system are expected to rise again despite the recent injection of 11 trillion VND by the government for SOCBs' equitization reform. While Vietnam's banks' return to assets is low at 1.4% on average, their return to equity is sizable. This may attributed to their relatively low equity.

Performance Ratios of the Banking System



Source: Merrill Lynch (2008)

But how does the performance of Vietnamese banking system compare with its counterparts in the East Asia region? Most indicators are quite similar to the banking system in Indonesia, Thailand, the Philippines, Malaysia, and China. Specifically, its loan loss reserve ratio is similar to that in Indonesia, Thailand and Malaysia. Its capital adequate ratio is similar to China but considerably lower than other Asian economies. The net interest margin of Vietnamese banks is lower than some emerging economies in the region, but it is similar to banks in Malaysia and China.

Estimated Financial Ratios of the Banking System

	Vietnam 2006	Indonesia 2006	Thailand 2006	Philippines 2006	Malaysia 2006	China 2006
1. Assets Quality						
Loan Loss Reserve / Gross Loans	5.33	5.41	6.30	7.09	4.82	2.33
2. Capital						
Equity / Total Assets	6.11	12.29	8.83	11.22	7.37	5.19
Capital Funds / Liabilities	6.33	14.16	12.01	15.36	10.48	7.36
3. Operations						
Net Interest Margin	2.51	5.66	3.46	3.87	2.11	2.25
Return on Average Assets (ROAA)	0.84	1.82	0.70	1.10	0.70	0.63
Return on Average Equity (ROAE)	13.71	14.80	7.91	9.76	9.48	12.23
Cost to Income Ratio	41.84	53.85	54.82	62.69	45.91	42.59
4. Liquidity						
Net Loans / Total Assets	60.56	45.40	67.08	36.89	54.83	53.88
Memorandom						
Number of banks included	30	52	36	52	71	90

Source: Bankscope (2008)

FOREIGN PARTICIPATION

Vietnam's WTO entry has sped up the reform of SOCBs. As a part of the latest round of banking sector reform measures announced in May 2006, all SOCBs are to be equitized and the government share of these entities is to be maintained at 51% by 2010, one year before foreign banks gain national treatment under Vietnam's WTO commitment (See Box 1).

Vietcombank is the first bank which the authorities want to partially equitize but negotiations with foreign strategic investors fell apart because of large differences over share prices. Instead, the government kept to its schedule and sold 6.5% share of the bank in its IPO at the Ho Chi Min Stock Exchange. An additional 20% share in the bank is expected to be sold this year. Given the current market conditions, it is highly doubtful the government will be able to fulfill its promise. The application for IPO is going to be dealt with case by case. It is reported that VietinBank and BIDV plan to gain listing on the domestic stock exchange by the end of 2008.

Box 1: Vietnam's WTO Commitments

Form of entry: Under Vietnam's commitments to the WTO, foreign credit institutions are permitted to establish a commercial presence in Vietnam in a number of forms including representative offices, branches of foreign commercial banks, commercial joint venture banks with foreign capital contribution not exceeding 50% of chartered capital, and banks with 100% foreign-owned capital after 1 April 2007.

Ownership restriction: For capital contribution in the form of buying shares, total equity held by foreign institutions and individuals in each of Vietnam's joint stock commercial bank may not exceed 30% of the bank's chartered capital, unless otherwise approved. Strategic investors may own no more than 15% of chartered capital of a bank, either individually or with affiliated entities. Strategic investors who wish to own 20% of chaptered capital of a bank will need prime minister's approval and also subject to a 5-year lock up period. No-strategic investor may own no more than 10% of the chartered capital of a bank and subject to a 3-year lock up period.

Domestic currency business: During the 5 years from the date of Vietnam's WTO accession, Vietnam may limit the right of a foreign bank branch to accept deposits in Vietnamese Dong from Vietnamese citizens with which the bank does not have a credit relationship to a ratio of the branch's allocated capital.

Foreign banking presence in Vietnam so far has been quite limited, much smaller than in Indonesia and the Philippines. In 2007, foreign banks only accounted for less than 8.8% of total deposits and about 9% of total lending. Foreign banks expanded to Vietnam mainly through their branches, wholly owned subsidiary banks, and joint-venture banks. The EU and the US banks currently enjoy the most favored regulatory treatment due to their respective bilateral trade agreements with Vietnam. There are 9 joint banks with foreign equity participation and they are mostly from the US, the UK, Germany, France, Japan and Singapore.

Foreign Strategic Investments in Vietnamese JSCBs

Vietnamese Bank	Asset Size in US$ million (as of 12/31/06)	Foreign Investor	Initial Investment in US$ million (Date)	Current % Ownership
Asia Commercial Bank	$2,901	Standard Chartered IFC Jardine Matheson Dragon Capital	$22 (Jun-05) $ 3 (Dec-02) $ 2 (Jan-97) $ 2 (Jan-97)	9% 7% 7% 7%
Sacombank	$1,609	ANZ Banking Group IFC Dragon Capital	$27 (Mar-05) $ 3 (Oct-02) $ 3 (Oct-02)	10% 8% 7%
Techcombank	$1,126	HSBC	$17 (Dec-05)	15%
Habubank	$985	Deutsche Bank	N/A (Pending)	10%
East Asia Commercial Bank	$864	Citigroup	$35 (Pending)	10%
Southern Commercial Bank	$663	United Overseas Bank	N/A (Jan-07)	10%
VP Bank	$660	Overseas Chinese Banking Corp.	$16 (Mar-06)	10%
Oricom Bank	$419	BNP Paribas	October 2007	20%
PVFC	$2,150	Morgan Stanley	N/A (Nov-07)	10%
An Binh Bank		Maybank		15%
Exim Bank	$225	SMFG	August 2007	15%

Source: Merrill Lynch (2008).

CHALLENGES AND OPPORTUNITIES

According to Merrill Lynch estimates (2008), Vietnam has about 7 million retail bank accounts out of 85 million people. This translates a market penetration ratio of only 8.2%. The government has announced that by January 2009, all 4 million civil servants will receive salaries by bank account instead of cash, thus helping increasing bank account and depositor base. As the Vietnamese economy becomes more sophisticated, it implies a huge growth potential for banking products and services. With increasing deposit and loan penetration, the banking industry is expected to continue to grow in real terms at twice the pace of the government's target GDP growth at 7 to 8% for 2006-10.

Indeed, the latest developments have already exceeded that projection. Loan growth accelerated to 36.6% in 2007 after a slowdown in 2006, while estimated deposit growth fell in 2007 to 30% from 36.5% in 2006. As a result, the loan to deposit ratio exceeded 100% in 2007 and is expected to increase further in 2008.

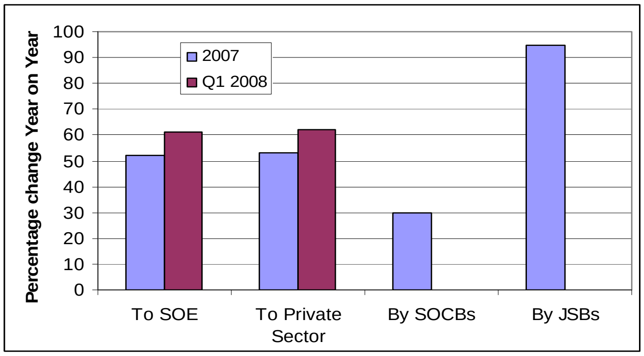
Growth in Loan and Deposit and Loan / Deposit Ratio

Note: the figure for 2007 is an estimate.

Source: IMF and BBVA estimates.

Such a rapid pace of credit expansion also forestalls problems in certain banks, particularly some JSBs that have experienced the fastest expansion (close to 100% loan growth in 2007). Huge amount of capital inflows fueled liquidity in the banking system and it is SOCBs and JSCBs that have intermediated most of capital inflows to both SOEs and non-SOE sectors. However, it appears that the SOCBs behaved more conservatively (with 30% loan growth in 2007) than their counterparts, the JSCBs, perhaps due to concerns of the expected equitization plan of SOCBs. Large capital inflows helped fuel rapid loan growth: over 50% in 2007 and over 60% in 2008 Q1, both on a year on year basis. Because of the lack of human capital and risk management skills in these newly set up JSCBs, most of their loans are in dubious quality and many smaller JSCBs have involved heavily in stock market lending and real estate market speculations. From interviews, it appears that JSCBs lent mostly to SOEs because of their relatively well established credit history and assumed state guarantee should a loan go bad by SOEs.

Credit Growth by Sector and by Type of Banks



Sources: State Bank of Vietnam for 2007 and World Bank projection for 2008.

Given the elevated inflation rate, residents may switch their portfolio holdings from bank deposit to some wealth preserving investment such as gold, foreign currency, and other valuables. This will leave some banks vulnerable to a deposit run. Indeed, it is expected that after the burst of the asset bubble in the stock and real estate market in 2008, the banking sector non-performing assets are expected to increase considerably and will come mostly from property developers and SOEs that have expanded aggressively outside of their core businesses. According to a report by the Ministry of Finance, SOEs have invested a total of USD7.3 billion or 10% GDP in financial investment and real estate, with the funding mostly coming from the banking system and JSCBs in particular. In addition to solvency issues, some weak financial institutions may face liquidity problem under much tighter monetary conditions.

However, a systemic crisis in the banking system may be less unlikely to occur given the majority of the banks is still in hands of the state and the government still has various means to close, take over, and merge weak banks with strong ones. In addition, the SBV will certainly act as lender of last resort to prevent a systemic run.

Indeed, the potential problem in the banking system could be an opportunity for foreign investors. The government has in the past put too high a price for strategic foreign investors to participate in the equitization of SOCBs. This has slowed the equitization process as no foreign bank is interested in buying at a price much higher than fundamentals would warrant. Given Vietnam's relatively high debt level by the East Asian standard, the government will likely to inherit more debt that could endanger its long-term physical sustainability. Thus, to limit the fiscal costs, it is argued that the government should not only allow some banks to fail, merge and consolidate with other ones, it should also facilitate the injection of foreign capital into the banking system, including raising foreign ownership ceiling and selling assets at realistic prices. If the government follows this rationale, the current situation could be a good opportunity for foreign investors to expand further in Vietnam's banking system.

Economic Research Department

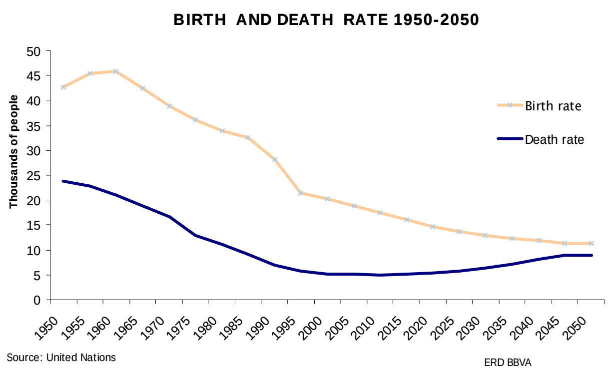
BBVA

Demography

June 2008

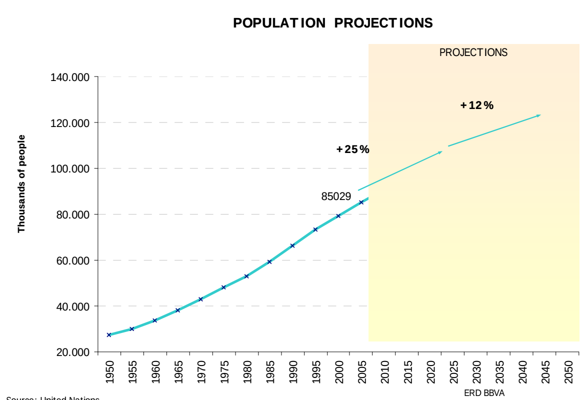
DEMOGRAPHIC PROJECTION

The latest official estimations made by the World Health Organization Statistics 2008 placed the Vietnamese population at 86.206.000 people.

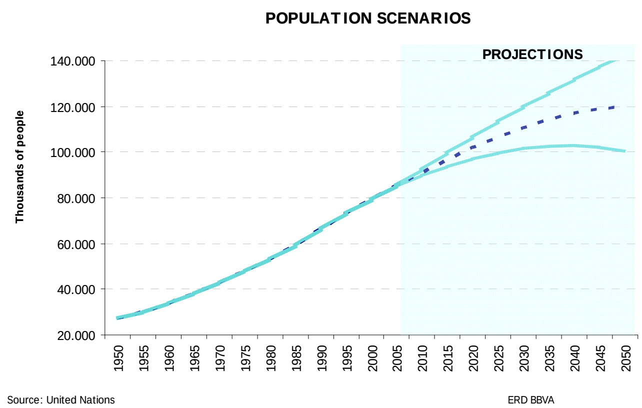


DEMOGRAPHIC TRANSITION

The average annual growth rate is of 1.5 percent for the period 2000 to 2007, the lowest population growth recorded since 1955, which shows that Vietnam is concluding the “second stage” of the demographic transition where both the mortality and the birth rates have already suffered a sharp decline, the demographic explosion has already taken place and the population will start ageing in the near future. Still, the Vietnamese population is young and growing and will continue to grow it in the near future.



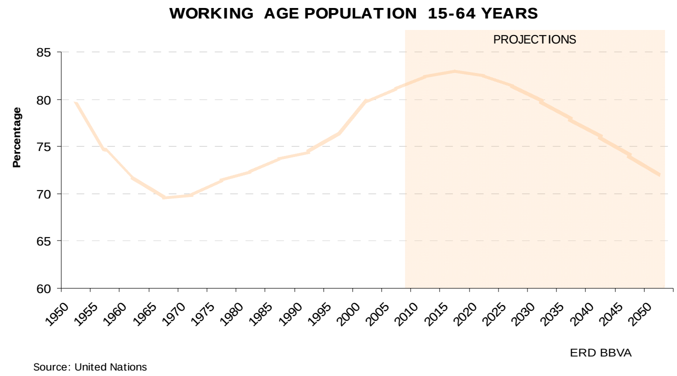
According to United Nations it is expected that by 2050, the population will reach almost 120 million people. In 2050 the birth rate is expected to be higher than the mortality rate, so vegetative growth is expected to remain positive.

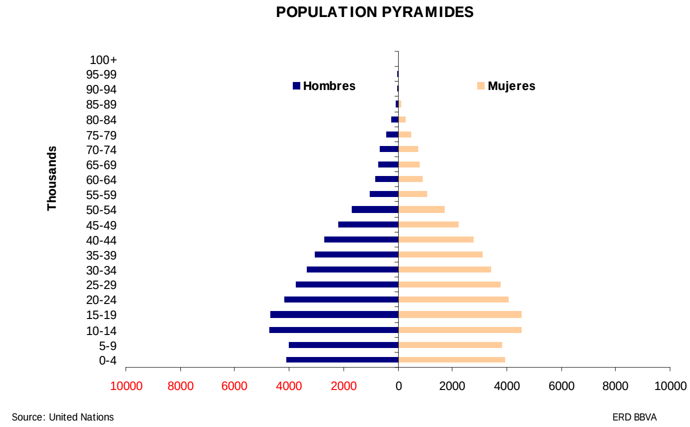


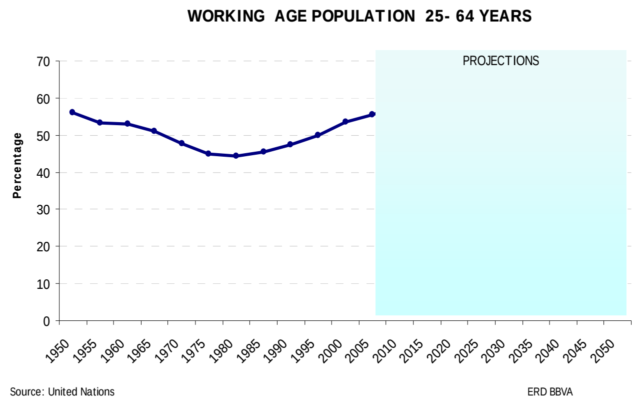
POPULATION STRUCTURE

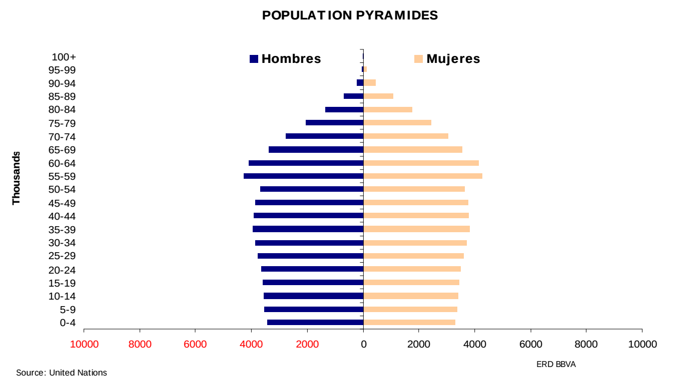
Nowadays, 79% of the population live in rural areas but we are witnessing a shift from rural to urban areas as new jobs are created in cities. The average annual growth rate of the urban population during the period 1997-2006 was 3.4% while it was just 0.7% for the rural population.

The age structure of the Vietnamese population is already showing the impact of the reduction in the fertility rate on the very young children (0 to 5 years) base at the bottom consisting of large numbers of children and a narrow top made up of relatively small number of elderly. Young dependents belonging to the age group 0-14 years comprise almost 30% of the population and old dependents (65 years and over) account for only 5.6 percent.

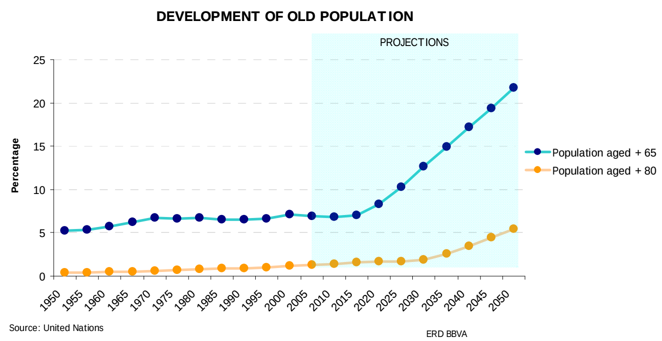








On the other side, the working age population (15 to 64 years) accounts for about 65% of the total and it is expected to fall down to 60% by 2050- while the old will rise their share to almost 20% and the child population will move to around 20%.



Gender distribution is quite balanced with about 41.4 million (49.14%) being males and 42.8 million (50.86%) females. Life expectancy at birth for males and females is 69 and 75 years old, respectively.

There are four major groups of emigrants from Vietnam: labour migrants working as contract workers in host nations; permanent migrants and asylum seekers; people temporarily living overseas but who seek employment and/or extensions of their stay while the fourth is made up illegal migrants.

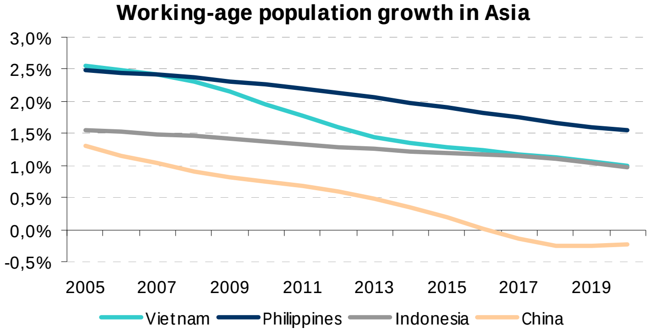
Labor Markets

June 2008

WORKING-AGE POPULATION

Demographics are evolving very rapidly. Working-age population (15-64 years) will keep on growing during the next decades, lowering the probability of a labor shortage scenario. However, the slow down, common in all Asian economies, will be particularly intense in Vietnam. Working-age population growth will converge to "Indonesian" growth rates, close to 1 per cent in 2020, from 2.5 per cent in 2007, according to UN projections.

Working-age population growth in Asia



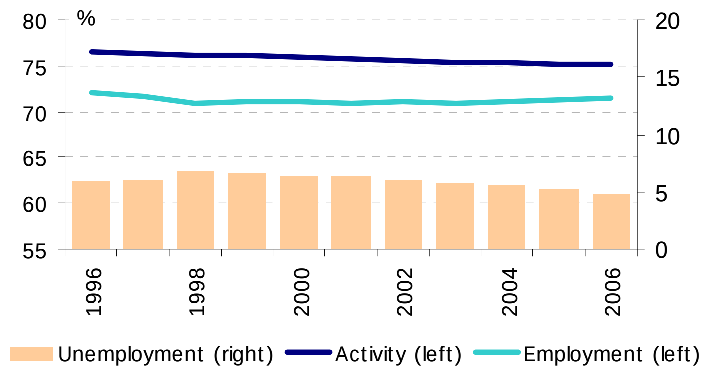
Source: ILO ERD BBVA

EMPLOYMENT RATE

Vietnam is close to its maximum labor utilization (high participation rate and very low unemployment).Labor market indicators are above the average in emerging Asia. The employment rate is 71 per cent (vs. 65 per cent as the average in China, Indonesia, Philippines and Vietnam), probably close to its maximum utilization.

Therefore, population slowdown (-2.5 percentage points between 2005 and 2020) will impact economic growth, unless other production factors are accumulated, or regulation is further improved. The shadow economy does not provide additional margin, since it is already limited (16 per cent of GDP, Schneider, F. (2007): "Shadow Economies and Corruption All Over the World: New Estimates for 145 Countries", *Economics E-journal*, July).

Labor market rates in Vietnam

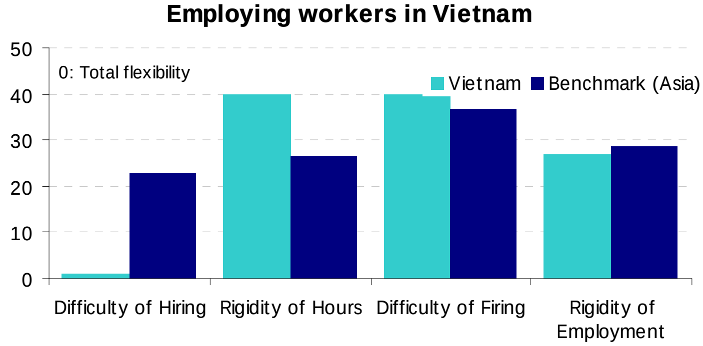


Source: ILO ERD BBVA

LABOR FLEXIBILITY

The Vietnamese labor market is one the most flexible in the region. According to *Doing Business 2008* (World Bank), the labor market ranks 84 out of 178 economies (a ranking close to Chile), in terms of flexibility in employing workers. The main strengths stem from a very relaxed hiring regulation, mainly thanks to the easiness to sign fixed-term contracts and to low minimum wages. Besides, non-wage labor costs are relatively low. In the future, legal advances may focus on the legal framework to adapt working hours among employees.

Employing workers in Vietnam



Benchmark: China, Indonesia, Phillipines, Vietnam
Source: Doing Business 2008 ERD BBVA

HUMAN CAPITAL

In the human capital front, a lot needs to be done (although some work is in progress). Some international reports highlight the recent spread of primary education since the late nineties. However, some statistics (World Bank (2006): *Meeting the challenges of secondary education in Latin America and East Asia*. Washington) point out that secondary education among working population is similar to that of Indonesia (although it seems that the Government's goal is to expand upper secondary education by 2010).

Labor indicators summary

Vietnam. Main labor market indicators

	1996-2000	2001-2005	2006	2007
Population				
Million	76.533	82.001	85.344	86.445
Active population				
Million	37.955	42.618	45.628	46.651
Employment				
Million	35.533	40.148	43.429	---
Unemployment rate				
Per cent	6,4	5,8	4,8	---
Informality				
% Employment	---	---	---	---
% GDP	15,6	17,0	---	---
Rigidity				
Doing Business Ranking	---	---	82 / 178	84 / 178
Human capital				
PISA Ranking	---	---	---	---
Secondary	---	---	11,7	---
Tertiary	---	---	5,8	---

Source: ILO, WB-Doing Business 2008, World Bank (2006) and Schneider (2007)

BBVA

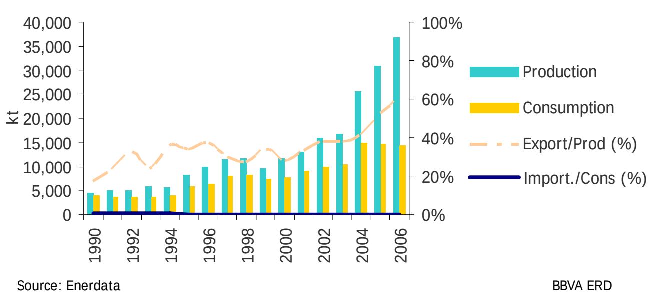
Energy

June 2008

GENERAL OVERVIEW

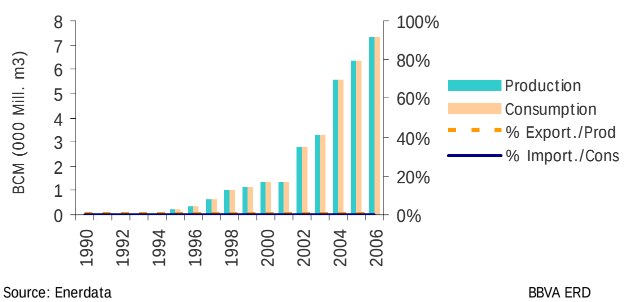
Vietnam holds 0.05%, 0.2% and 0.02% of world oil, gas and coal proven reserves respectively. Despite these limited energy resources Vietnam is a net energy exporter of coal (it exports 60% of its coal production) and oil (it exports 95% of its crude production). In the first case, this is explained by a surplus of coal (see next graph), whereas in the second case it is due to a lack of refining facilities (see section on oil market perspectives)

Coal Balance. Vietnam 1990-2006



Vietnam is self sufficient in natural gas. It does not export or import any gas. The gas sector is still in its infancy but it is increasing rapidly as the use of gas for generating power becomes more generalized. Gas is barely used for final uses in the industry or residential sectors.

Natural Gas Balance. Vietnam 1990-2006

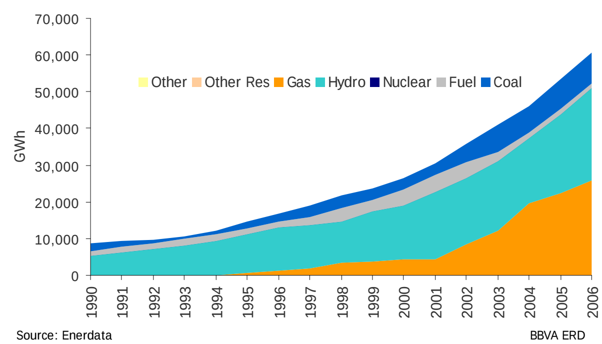


Almost 50% of energy needs are covered with traditional biomass and the rest with fossil fuels (9% gas, 29% coal and 25% oil).

Hydroelectricity was the main source for electricity generation until 2000 but natural gas is rapidly increasing its share and now it even has a slightly bigger share than hydro. Other modern renewable energies and nuclear are inexistent in the electricity mix.

Access to electricity has increased rapidly from little over 50% in 1996 to over 85% of current households, and this is expected to increase further according to the International Energy Agency (IEA). Nevertheless, more than 80% of Vietnam's population still relies heavily on non-commercial energy in the form of traditional biomass resources such as wood, animal dung and rice husks.

Gross electricity generation by source. Vietnam1990-2006



The Vietnamese energy sector is in an early stage of development as the structure of final energy consumption shows, both by energy sources and consuming sectors. Traditional biomass accounted for more than 80% of final energy needs in 1990 but now this percentage is approaching 50% as oil and oil and electricity increase their penetration in the final energy mix.

As for final users, households account for nearly 60% compared to 28% for China or 43% for Indonesia.

Oil consumption is subsidized, especially diesel, but the government has announced that it will cut these subsidies next year. The energy intensity of Vietnam has registered a 30% decrease since 1990 but the country is still very energy inefficient. Potential for improvement exist as subsidies are cut and the energy mix evolves towards a higher share of more modern energies such as gas or electricity.

Finally, Vietnam's per capita carbon emissions are very low by regional comparisons, so CO2 emissions do not pose significant concerns for the moment.

Primary energy statistis for selected countries (2005)

	Vietnam	China	OECD
Total Primary Energy Supply (TPES) (Mtoe)	51	1717	5548
TPES per capita (toe/capita)	0.62	1.32	4.74
TPES/GDP (toe/000 2000 US$)	1.15	0.91	0.2
TPES/GDP (PPP) (toe/000 2000 US$ PPP)	0.23	0.22	0.18
Electricity consumed per capita (kWh/capita)	573	1781	8365
CO_2* per capita (t CO_2/capita)	0.97	3.88	11.02
CO_2/GDP (kg CO_2/2000 US$)	1.8	2.68	0.45
Net Imports (Mtoe)	-18	100	1813

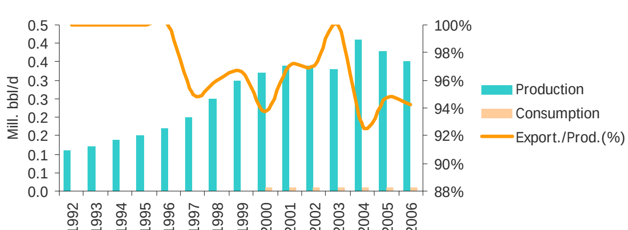
Source: International Energy Agency

**CO_2 Emissions from fuel combustion only.*

OIL MARKET PERSPECTIVES: OIL EXPORTS SHOULD DROP AS REFINERY BOTTLENECKS DISAPPEAR

Vietnam's oil sector is emerging. 80% of crude production comes from one field.

Oil Balance. Vietnam 1990-2006



Source: Enerdata BBVA ERD

Consumption of oil products has been traditionally low due to the underdevelopment of private transportation, but it is now growing quickly. Despite being Southeast Asia's third-largest crude producer, Vietnam relies almost entirely on oil product imports as it lacks major refineries. At present, almost all oil produced is exported to Singapore where it is refined.

However, the country has plans to increase substantially its refinery capacity and aims to become oil self-sufficient by 2015.

After more than five years of delay, the first oil refinery is being constructed by the oil monopoly PetroVietnam near Dung Quat. It will cost 2.5 billion USD for a capacity of 140,000-bbl/d, and it will become operational in early 2009. The suboptimal location of the plant (far from both production and consumption main areas) was one of the main obstacles for securing the financing of the project.

A $6 billion joint venture contract for a second refinery project has been recently closed with international investors from Japan and Kuwait. The plant may be in operation by 2013. It will have a capacity of 200,000 bbl/d and will be located in the north of the country (close to end-users but far from the main producing areas).

PetroVietnam is also holding talks with Venezuela' PDVSA for a third refinery with capacity of at least 140,000 bpd in the country's southern region (its top fuel consumption centre) that would cost US 7 billion and start operation in 2015.

In addition to the three main refineries, the government has also licensed a number of smaller private refineries but lack of funding and access to secure crude supply remain an obstacle to project materialization.

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