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AUGUST 2024

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Abbreviations

ASEAN	Association of Southeast Asian Nations
AUM	Assets under management
BPS	Basis points
CIT	Corporate Income Tax
COVID-19	Coronavirus disease-19
CPI	Consumer Price Index
FDI	Foreign Direct Investment
FOLs	Foreign ownership limits
FX	Foreign exchange
GDP	Gross Domestic Product
GSO	General Statistics Office
GVC	Global Value Chain
HNX	Hanoi Stock Exchange
HOSE	Ho Chi Minh Stock Exchange
IDX	Indonesia Stock Exchange
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPI	Industrial Production Index
IPO	Initial Public Offerings
KLSE	Bursa Malaysia
LF	Labor force
LHS	Left-hand scale
MoF	Ministry of Finance
NAV	Net Asset Value
NPL	Non-Performing Loan
PIT	Personal Income Tax
PMI	Purchasing Managers Index
PP	Percentage Point
Q/q	Quarter-over-quarter
SBV	State Bank of Viet Nam
SET	Stock Exchange of Thailand

SSC	State Securities Commission
STI	Straits Times Index
UPCOM	Unlisted Public Company Market
VAT	Value-Added Tax
VBMA	Viet Nam Bond Market Association
VND	Viet Nam Dong
VNIBOR	Viet Nam Interbank Offered Rate
VNX	Viet Nam Exchange
VSS	Viet Nam Social Security
WB	World Bank
WBG	World Bank Group
Y/y	Year-over-year

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Overview

Economic Developments and Prospects

Growth accelerated in the first half of 2024

Viet Nam's GDP grew by 6.4 percent (y/y) in H1-2024 after a moderate 5 percent growth in 2023, boosted by a rebound in manufacturing exports as well as higher consumption and investment. Merchandise trade was more robust than expected in H1-2024, fueled by stronger external demand, with exports and imports growing at 16.9 and 17 percent (y/y), respectively. While the net export contribution to GDP remains modest, expanding trade was accompanied by a gradual recovery of domestic demand with investment and consumption growth recording 6.7 and 5.8 percent (y/y) in H1-2024, respectively.

On the production side, manufacturing, export-oriented services, and tourism posted robust growth. Manufacturing output grew by 7 percent (y/y) in H1-2024 from a low base and drove growth in 2024 so far, accounting for a quarter of GDP growth. Services continued to account for more than half of GDP growth and climbed by 7.4 percent (y/y) in H1-2024. Export-oriented services (transport and warehousing) benefited from a resurgence in goods exports, as well as the recovery of the hospitality sector, with the number of foreign tourists reaching 8.8 million in June 2024, above pre-COVID levels.[1] The agriculture sector's contribution remains stable, at 0.4 percentage points.

Despite recovering, consumer spending remained below pre-pandemic rates. Retail sales grew 8.8 percent in H1-2024, driven by goods sales on a stable trajectory since late 2022, but below a pre-pandemic average of 11.6 percent. Especially demand for durable and non-essential goods and services, such as vehicles, consumer appliances, holidays, and home renovations remains weak, suggesting persistent frailty in consumer confidence. Real income growth continues to be muted at 2.5 percent (y/y) in June 2024, on par with annual 2.7 percent average growth since 2022 – but below pre-pandemic trends (8.4 percent). Similarly, formal employment remained relatively stable with a 0.4 percent (y/y) improvement in April 2024.

Private investment growth accelerated in H1-2024 but remained below pre-COVID levels. Recovering manufacturing exports contributed to a pick-up in investments. Total investment registered 6.8 percent growth (y/y) in H1-2024, up from 4.8 percent (y/y) in H1-2023, but below a pre-COVID average of 7.1 percent (y/y). Similar to total investment, domestic private investment – close to 60 percent of total investment - contributed 3.9 percentage points (y/y) growth in H1-2024, below its annual average of 4.7 percentage points over 2017–19. Foreign investments represented the largest increase in investment categories in H1-2024, up 13 percent (y/y). Meanwhile, public sector investment[2] growth eased to 4

[1] General Statistical Office, Viet Nam.

[2] Including state-owned enterprises' investment

percent (y/y) in H1-2024 compared to 20.5 percent in H1-2023, following a boost in public investment in 2023 to support the economy.

Viet Nam's external position deteriorated as increased informal capital outflows offset current account and financial account surpluses

The current account registered a substantial surplus, driven by a robust trade performance. The current account registered a surplus of 5.1 percent of GDP in Q1-2024[3] compared to 2.1 percent in Q1-2023, thanks to a trade surplus of 11.7 percent of GDP in Q1-2024, up from 8.7 percent in Q1-2023, underpinned by a large rebound in merchandise exports. With a steady FDI inflows (3.4 percent of GDP in Q1-2024), the financial accounts also registered a surplus in Q1-2024, albeit a smaller one than in Q1-2023 due to higher outflows of portfolio and other investment (net outflow of 2 percent of GDP compared to net inflow of 0.1 in Q1-2023) as foreign investors realized gains on their investments.

However, a continued interest rate differential and strengthening US dollar in H1-2024 increased unrecorded capital outflows leading to a negative external position. The gap between the Viet Nam dong and US dollar overnight rates remained substantial (166bps) in H1-2024 despite recent increases in the overnight interest rate in Viet Nam, exacerbating capital outflows in search of better yields. In the meantime, given the strengthening dollar, the VND/US$ exchange rate weakened from VND 24,258 in December 2023 to VND 25,334 by the end of June 2024 on the market rate. Seeking another investment instrument, domestic demand for gold sharply increased (+28.6 percent (y/y)) which, combined with supply controls, led to a substantial price premium that fueled informal gold imports and purchases. Net errors and omissions – which include unrecorded capital outflows, quadrupled from 1.9 percent of GDP in Q4-2023 to 7.9 percent in Q1-2024, far exceeding the 2017–19 average (2.5 percent), leading to an overall BOP deficit of US$1.37 billion in Q1-2024.

The SBV responded to emerging exchange rate pressures through a combination of gradual devaluation, FX interventions, and tighter liquidity. The SBV depreciated the central rate by 1.2 percent between January and June 2024, allowing the market rate to depreciate further by 3.6 percent in the same period. It used foreign exchange interventions to mediate depreciation pressures against the dong and foreign exchange reserves were estimated to have fallen from US$90 billion in December 2023 to around US$83–84 billion by the end of June 2024 (equivalent to 2.7 months of imports). In addition, the SBV began withdrawing liquidity from the interbank market in mid-March 2024 by issuing a higher SBV bill rate (4.25 percent). This bumped up the average overnight interbank interest rate from 0.9 percent in March 2024 to 4.25 percent in May 2024, before decreasing to 2.8 percent in June 2024. These interbank interest rate increases softened pressure on the currency.

Headline inflation increased to 4.3 percent (y/y) by June 2024 due to elevated food prices. Rising food prices were the largest contributor to the CPI increase (+0.8 pp since January) as pork prices climbed sharply due to outbreaks of African swine fever. Core inflation (which excludes food, fuels, and government-administered prices) continued to decline, falling to 2.6 percent (y/y) in June 2024 from 4.3 percent (y/y) in June 2023.

[3] Latest data available at time of writing

Amid the economic recovery, credit growth picked up slowly and bank asset quality remains a significant concern

Credit growth improved after a sluggish start to 2024. By the close of June 2024, credit growth hit 13.5 percent (y/y), driven by improvements in manufacturing, real estate, and trade, transportation, and telecommunications. However, the latest data on consumer loans suggests subdued consumer sentiment as homebuying and auto loans in Q1-2024 declined compared to the end of 2023. Total consumer loans grew by only 6.8 percent (y/y) in Q1-2024, on the back of soft growth in 2023, lower than the average (y/y) growth rate of 16.1 percent in the previous five years.

Bank asset quality has remained a concern since 2023. System-wide non-performing loans (NPLs) have grown significantly, from 1.9 percent in 2022 to 4.6 percent of total loans in 2023, based on the latest available data, driven largely by the recognition of bad debts held by Saigon Joint Stock Commercial Bank (SCB). However, total problem loans could be as high as 7.9 percent if restructured loans and Viet Nam Asset Management Company (VAMC) debts are included. Latest Q1-2024 data suggests that the NPL ratios of 27 listed commercial banks, which account for 83 percent of total outstanding credit in the banking sector, rose from 1.9 percent in Q4-2023 to 2.2 percent in Q1-2024, amid rising bad debts coupled with sluggish credit growth. In addition, the expiration of pandemic forbearance measures, set to end in December 2024, may further increase NPL levels. Provisions for loan losses remain uneven among banks and in some cases, insufficient against rising bad debts. The potential need to increase provisioning, adding loan-loss reserves, is placing additional pressure on bank profitability already squeezed by a slowdown in net interest income, fees, and commissions.

Meanwhile the corporate bond market showed signs of recovery. Corporate bond issuances increased by 2.5-fold in H1-2024 compared to the same period in 2023, as banks took advantage of the lower interest rate environment to refinance bonds. However, bonds maturing in the second half of 2024 are estimated at VND 139.8 trillion (US$5.6 billion), with real estate bonds comprising 42 percent, placing the property sector under pressure amid cash flow challenges. Beyond these short-term developments, the gradual rebalancing of Viet Nam's financial system towards a more prominent role of capital markets remains an important agenda, as discussed further in this edition's special topic chapter.

Fiscal consolidation resumed in H1-2024 after a moderately expansionary 2023

The fiscal balance registered a surplus of 4.2 percent of GDP in H1-2024, compared to 1.5 percent in H1-2023, due to higher public revenues and reduced public spending. Public revenues climbed to 19.5 percent of GDP in H1-2024 (+1 pp compared to H1-2023), driven by higher capital revenues from land sales (+0.7 pp) and larger tax revenues from Corporate Income Tax (CIT) and Value Added Tax (VAT) collections (+0.5 pp). At the same time, public spending slowed by 1.6 percentage points of GDP from 17 percent in H1-2023 to 15.4 percent in H1-2024, due to cost-cutting in recurrent expenditures and lower public investment disbursement (4.5 percent of GDP in H1-2023 to 3.7 percent in H1-2024). By the end of June 2024, only 29 percent of the National Assembly approved budget for 2024 was implemented, with public investment disbursement 6 percent lower than the same period in 2023. Slow capital disbursement was attributed to delays in land clearance and compensation for major national highway projects, scarcity of backfill materials (stone and sand), and fluctuating prices of raw materials.

Viet Nam's economic prospects are positive, with broadly balanced risks

Viet Nam's economy is forecast to grow by 6.1 percent in 2024, rising to 6.5 percent in 2025-26 (Table 0.1). This projection assumes an easing of manufacturing exports growth in H2-2024, after a 16.9 percent rebound (y/y) in H1-2024 and the expected moderation of global demand in 2024, in particular the United States, Viet Nam's largest export market. The real estate market is showing signs of a recovery and is forecast to turn the corner in late 2024 and into 2025 as the corporate bond market freeze has eased and the Land Law came into effect from August 2024. With continued export growth and signs of a real estate recovery, domestic demand is set to firm up in H2-2024 as investor and consumer sentiment improve. The current account balance is projected to retain a small surplus, while the government resumes fiscal consolidation, and projected inflation slows from 4.5 percent in 2024 to 3.5 percent in 2026.

Table 0.1. Selected economic indicators, Viet Nam 2021-26

Indicator	2021	2022	2023	2024e	2025f	2026f
GDP growth (%)	2.6	8.0	5.0	6.1	6.5	6.5
Growth of expenditure components						
Private consumption	2.0	7.8	3.5	5.3	5.9	5.9
Public consumption	4.7	3.6	4.9	5.5	5.4	5.4
Investment	3.7	5.8	4.1	6.8	7.0	7.2
Exports	13.9	4.9	-2.5	11.4	7.4	8.0
Imports	15.8	2.2	-4.3	11.7	7.0	7.7
Consumer Price Index (average, %)	1.8	3.1	3.3	4.5	4.0	3.5
Current account balance (% of GDP)	-2.2	0.3	5.8	0.9	1.0	1.0
Fiscal balance (*) (% of GDP)	-1.4	0.7	-2.4	-0.8	-0.4	-0.2
Public & publicly guaranteed debt (**) (% of GDP)	42.5	37.1	36.0	35.7	35.0	34.6

Source: GSO; MoF; SBV; IMF; and World Bank staff calculations.

Note: e = estimate; f = forecast, *: excluding unallocated expenditures and following Government Finance Statistics (GFS), **: calculated based on Decision No. 458/QD-TTg (April 28, 2023) related to the plan for borrowing and repaying public debt in 2023 and for 2023-25, Resolution No. 105/2023/QH15 (November 10, 2023) related to the government's 2024 budget.

Among downside risks, the main uncertainties stem from slower-than-expected global growth, particularly among major trading partners such as the United States, European Union, and China. Such developments could impact Viet Nam's manufacturing exports and weigh on growth. Domestically, a weakening of macroeconomic stability could erode consumer confidence and impact consumption and investment. The real estate market recovery could take longer than expected, adversely impacting private sector investment. If the financial sector's asset quality were to weaken further, bank lending capacity could be undermined. As one of the world's most vulnerable countries to climate change, increasingly intensifying climate-related natural disasters could pose additional downside risks.

This outlook could also be subject to potential upside developments. Stronger-than-expected global growth could spur a sustained recovery in Viet Nam's export sector. More accommodative monetary policy in major advanced economies has already been initiated by the European Central Bank and the Bank of England, coupled with the U.S. Federal Reserve signaling a possible rate cut by September, which could further support demand in advanced economies and boost Vietnamese exports. This could also contribute to an easing of global financing costs and close the VND/US$ interest rate gap, with potential positive spillovers into the banking and financial sector in Viet Nam.

Reaching New Heights in Capital Markets

Underpinned by robust macroeconomic conditions, Viet Nam's capital markets have developed strongly over the past decade. Healthy economic growth, a stable exchange rate, low inflation, and political stability have positioned Viet Nam's capital markets to catch up with regional peers in terms of their relative size, reaching above 90 percent of GDP in 2023, on par with Indonesia. Well-functioning capital markets are critical to mobilize resources, as part of inclusive, resilient, and modern financial markets.

However, when evaluated through its success in intermediating finance, Viet Nam's capital market indicators still indicate an opportunity for further growth. It is critical to look at three functions of financial intermediation that capital markets have, namely funding, savings, and pricing functions. Regarding funding, despite a high equity market capitalization, the amount of funds raised through the stock exchanges over the past five years has been relatively small. Fundraising through the bond markets was relatively more significant, especially corporate bonds; however, long-term financing remains limited and weaknesses in the market foundations have been exposed recently. On savings, the total amount of savings mobilized through institutional investors is still low, only 19 percent of GDP, smaller than most regional peers, limiting the amount available for long-term investments. Meanwhile, on pricing, capital markets have not provided strong price reference due to unclear short-term interest benchmark, inefficiencies in the government bond market, and high volatility in stock prices.

If Viet Nam is to unlock the potential of its capital markets, several specific hurdles need to be overcome to ensure healthy and sustainable growth. A fundamental issue in Viet Nam is the underdevelopment of the institutional investor base, including the underutilization of the Viet Nam Social Security fund (VSS), a potentially dominant force in driving capital market development. The absence of a large weight of institutional investors in the corporate securities markets also allows individual investors to dominate, which can create volatility from herd behavior. This also contributes to the accumulation of risks within the corporate bond market and stunts the development of the equity market to play its financing role for the corporate sector.

The almost exclusive placement of the VSS portfolio in government bonds limits investment returns, creates price inefficiencies, and adversely impacts financial sector development. Managing a portfolio equivalent to 10 percent of GDP, VSS is the single largest institutional investor in Viet Nam, larger than all other domestic institutional investors combined. However, due to a legal constraint, VSS assets are heavily concentrated in government bonds. VSS has become a captive investor for government bonds, causing artificially low yields in auctions, and thus distorting the price function of the government bond market.

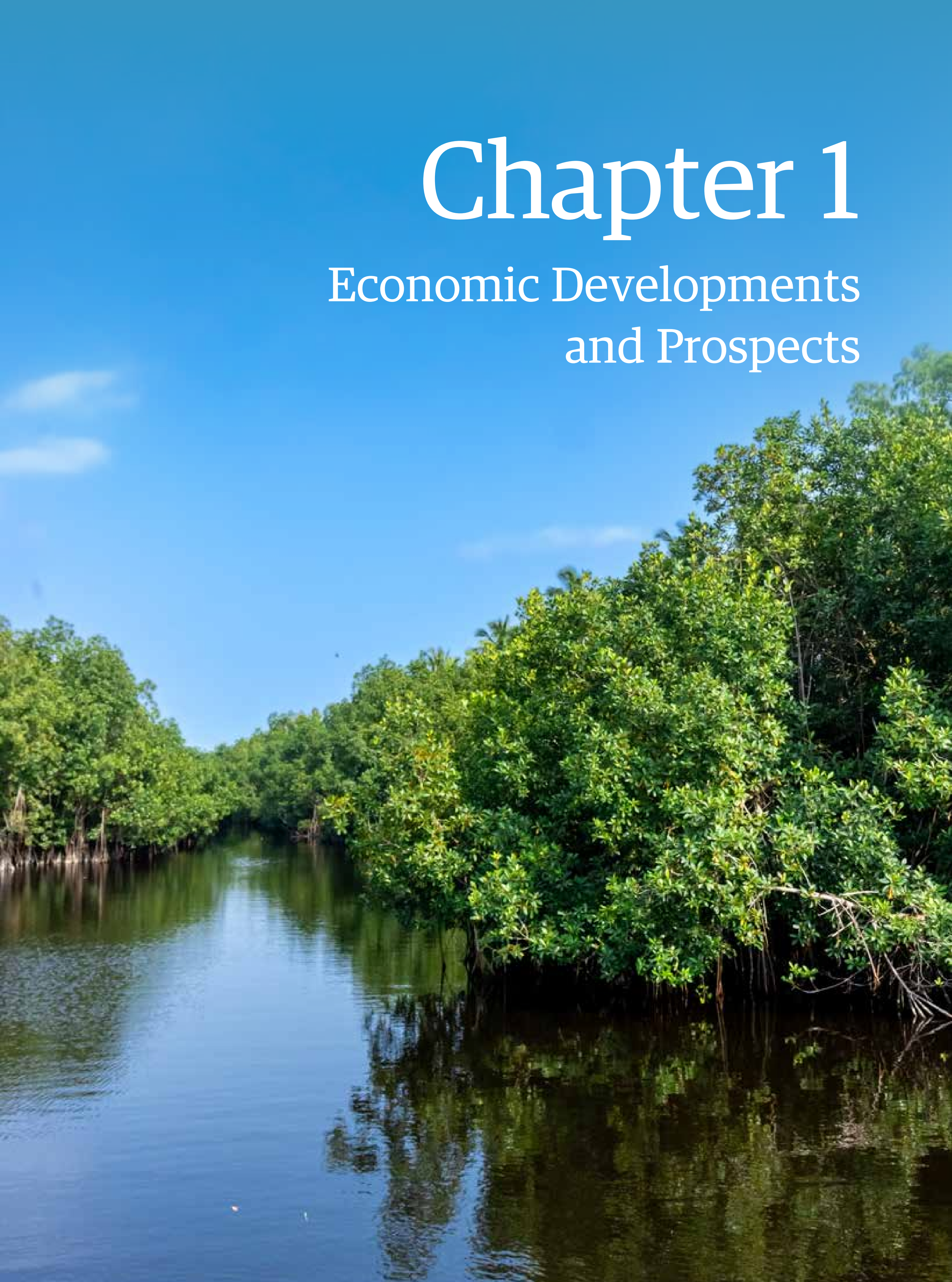
VSS investment diversification would accelerate the modernization of Viet Nam's financial system in several ways. It would remove it from a captive status in the government bond market, reduce market distortions and improve the pricing signals. Further, VSS diversification into corporate securities markets – stocks and bonds – would support development of these markets through investor diversity and provide relative market stability as a long-term investor. If properly implemented on a small and gradual basis, such diversification would increase returns on VSS investments in the long run.

Other institutional investors should add their weight to drive corporate sector development. Life insurers are relatively sizeable, but they are also concentrated in government bonds and bank deposits. This means corporate securities markets are dominated by non-professional investors prone to herd behavior and vulnerable to mis-selling and abuse. This also means higher quality issuers across all economic sectors are not encouraged to come to market, since long-term funding opportunity is limited. In developed markets, pension funds and institutional investors are key purchasers of corporate equities, bonds, money market funds and niche investment funds, as well as drivers of development of other instruments. In Viet Nam, action is needed to develop investor professionalism, through institutional investors, namely insurance companies, private pension funds, and investment funds.

A concerted effort to develop the capital markets should be a key objective of the government and all stakeholders. Healthy growth in capital markets would also bring positive externalities to the overall economy, through efficient allocation of capital. Viet Nam will be able to achieve a higher economic growth, not only because domestic resources are used more productively, but also because it is leveraged with much-needed capital from the international market to achieve its ambitious high-income goal.

Chapter 1

Economic Developments and Prospects

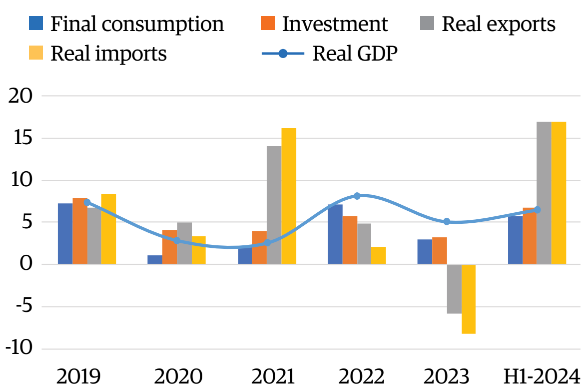


I. Recent Economic Developments

Growth accelerated in the first half of 2024

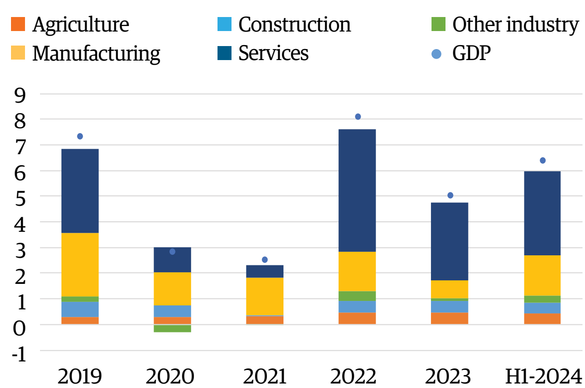
Viet Nam's GDP grew by 6.4 percent (y/y) in H1-2024, after moderate 5 percent growth in 2023, driven by a rebound in manufacturing exports as well as higher consumption and investment. Merchandise trade was more robust than anticipated in H1-2024, fueled by stronger demand from United States consumers, with exports and imports growing at 16.9 and 17 percent (y/y), respectively. While the net export contribution to GDP remains modest, expanding trade was accompanied by higher industrial production and employment - leading to an uptick in investment and consumption growth of 6.7 and 5.8 percent (y/y) in H1-2024, respectively (Figure 1.1).

Figure 1.1. Growth accelerated in H1-2024 driven by a rebound in trade
Growth of GDP demand components, percent (y/y)



Source: GSO and World Bank staff calculations

Figure 1.2. Mirroring the recovery of trade, recovering manufacturing sector was the main driver of growth
Contribution of GDP supply components, percentage points (y/y)

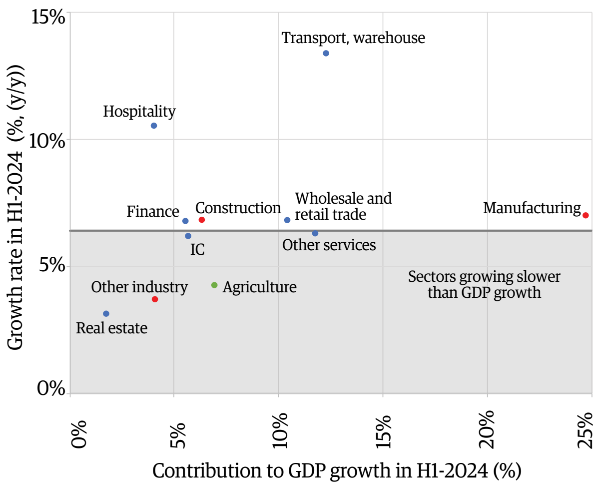


Source: GSO and World Bank staff calculations
Note: Not showing contribution from net taxes on production. Agriculture includes Agriculture, Forestry and Fishery

Driven by the rebound in external demand, industrial production and export-oriented services recovered

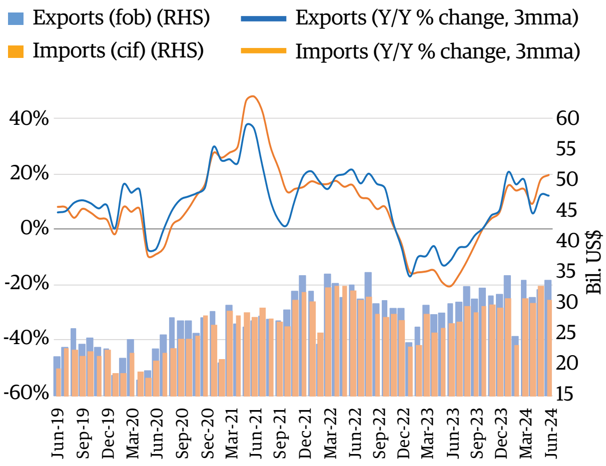
On the supply side, GDP growth was led by increased manufacturing, export-oriented services, and tourism. Manufacturing output grew by 7 percent (y/y) in the first half of 2024 from a low base, representing a quarter of GDP growth compared to a 14 percent share in 2023. Services continued to account for more than half of GDP growth and climbed by 7.4 percent (y/y) in H1-2024 (Figure 1.2). The main drivers were manufacturing production, export-oriented services (transport and warehousing) as beneficiaries from a resurgence in goods exports, and the hospitality sector boosted by a growing number of foreign tourists reaching 8.8 million in June 2024, surpassing the 2019 peak (Figures 1.3-1.5). The agriculture sector's contribution remains stable, at 0.4 percentage points.

Figure 1.3. Export-oriented manufacturing and services drove GDP growth



Source: GSO and World Bank staff calculations. Colored dots represent sectors (red=industry, blue=services, green=agriculture)

Figure 1.4. Continued recovery of merchandise trade since 2023



Source: GSO and World Bank staff calculations

Domestic demand also improved but remains below pre-COVID levels

Private investment growth accelerated in the first half of 2024 but remains below pre-COVID levels. Recovering manufacturing exports contributed to a pick-up in investments. Total investment registered 6.7 percent growth (y/y) in H1-2024, up from 4.1 percent (y/y) in 2023, but slightly below pre-COVID average growth of 7.1 percent (y/y) (Figure 1.6). Similarly, the growth of domestic private investment – close to 60 percent of total investment -contributed 3.9 percentage points (y/y) to investment growth in H1-2024, below its 4.7 percentage points contribution over 2017–19. Foreign investments represented the largest increase in H1-2024 with 13 percent (y/y) growth, supported by an uptick in manufacturing investment, representing about 75 percent of FDI commitments. Meanwhile, public sector investment[4] growth eased in H1-2024 to 4 percent (y/y) compared to 20.5 percent in H1-2023.

[4] Including state-owned enterprises' investment

Figure 1.5. Merchandise export growth has rebounded, driven by electronics

Contribution to good export growth (percentage points, (y/y))

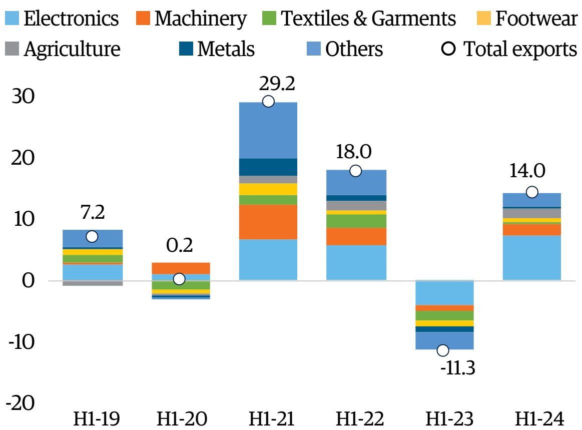
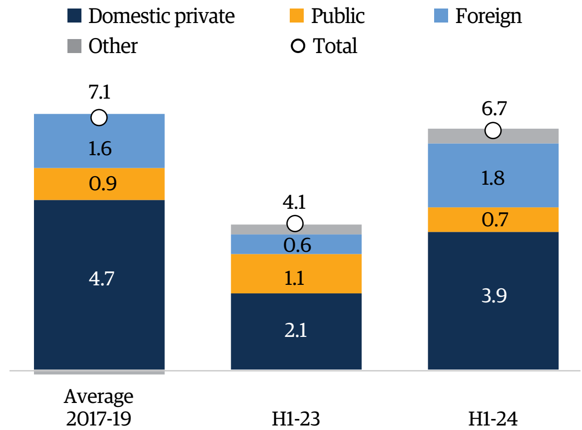


Figure 1.6. Private investment is recovering

Contribution to real investment growth (percentage points, y/y)



Source: GSO and World Bank staff calculations

While recovering, consumption remained below pre-pandemic rates, as low consumer confidence dampened sales of durable and non-essential goods. Retail sales grew 8.8 percent in H1-2024, driven by goods sales on a stable trajectory since late 2022, but below a pre-pandemic average of 11.6 percent (Figure 1.7). Low consumer confidence was still impacted by the relatively weak economic performance from 2023 and continued to dampen demand for durable as well as non-essential goods and services, with a decline in sales of vehicles and motorcycles (Figure 1.8) and lower reported purchases of expensive appliances, holidays, and home renovations. The consumption of essential items such as food, education and healthcare continued to grow (Figure 1.9).

Figure 1.7. Growth in retail sales is stable but below pre-COVID trends…

Retail sales growth (percent (y/y))

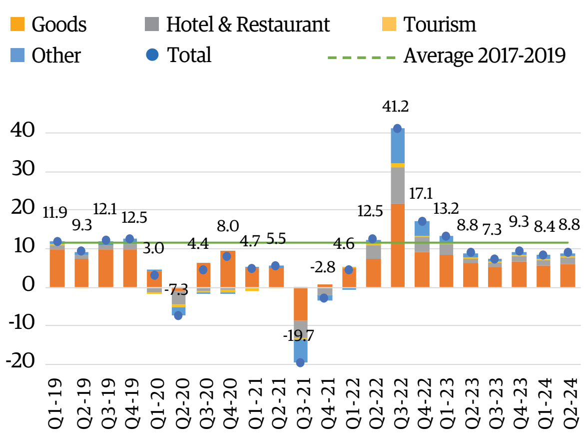
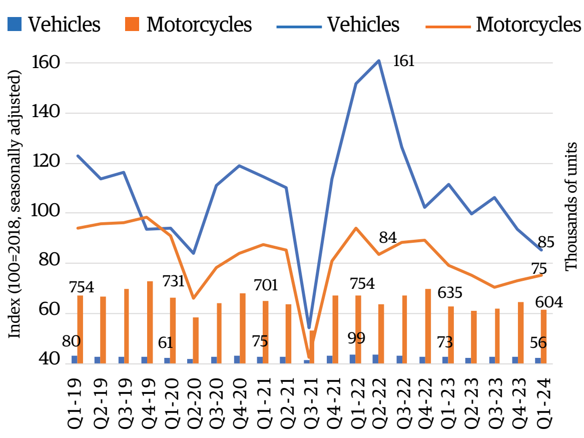


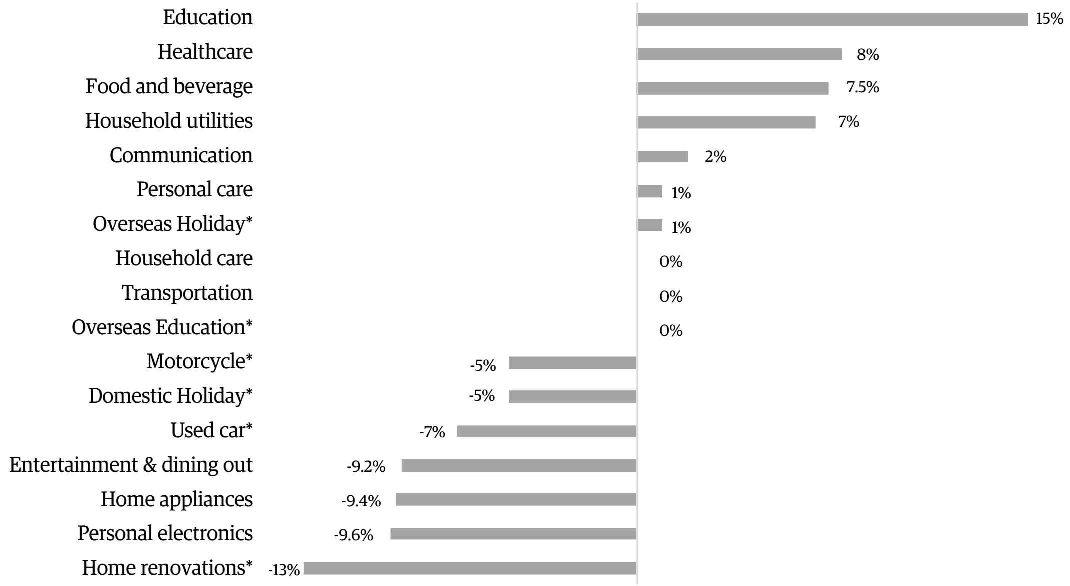
Figure 1.8. …while durable goods sales are declining

Sales of vehicles and motorcycles



Source: GSO and World Bank staff calculations

Figure 1.9. Lower consumer confidence is cooling demand for non-essential goods
Reported change in real consumption or purchase intent in June 2024



Source: InFocus Mekong survey and World Bank staff calculations
Note: * indicates purchase intent, other items show the share of respondents reporting an increase in real consumption

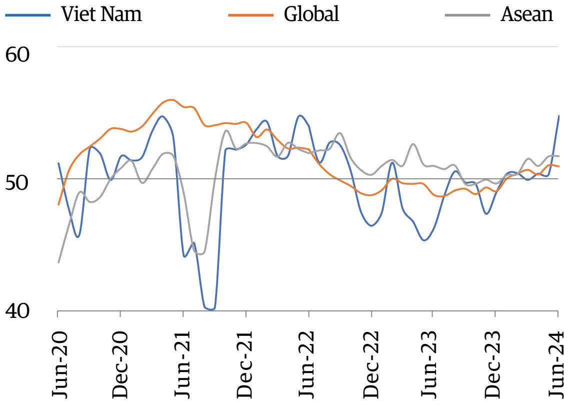
Growth in manufacturing output outstripped employment growth, leading to productivity gains

Industrial output bounced back from a low base, driven by growth in electronics, petroleum, and minerals production. Manufacturing in Viet Nam was robust in the first half of 2024, and particularly in June with the Industrial Production Index (IPI) reaching 166 (+14.3 percent (y/y)). The Purchasing Managers Index (PMI) also rose sharply, touching 55[5] - its highest level since June 2022 - well above the ASEAN average, reflecting faster growth of manufacturing orders than in the region or globally. Manufacturing production improvements were driven by the electronics sector (+39pp (y/y)) increase in the IPI in June 2024), petroleum (+34pp) and metal products (+45pp). Footwear and textiles production also climbed from a low base (Figures 1.10 and 1.11).

[5] The PMI is an indicator of manufacturing orders based on surveys of manufacturing firms' purchasing managers. The IPI is an index of manufacturing production capacity based on the level of industrial output.

Figure 1.10. Manufacturing production rebounded...

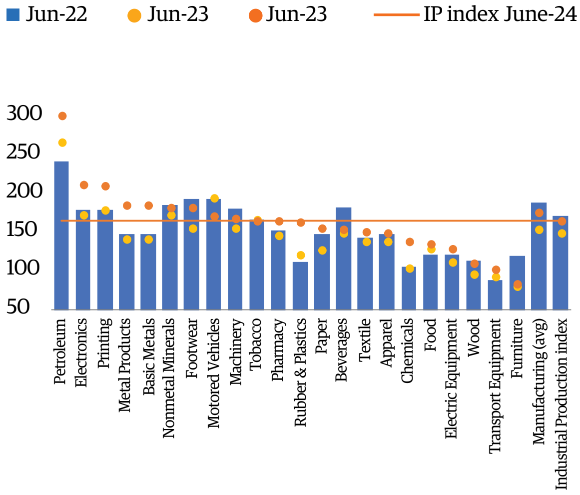
Manufacturing PMI



Source: S&P Global and World Bank staff calculations
Note: a PMI above 50 suggests manufacturing expansion. A PMI below 50 suggests a contraction in manufacturing activities

Figure 1.11. ...driven by electronics, petroleum, and mineral products

IPI by sector (2015=100)

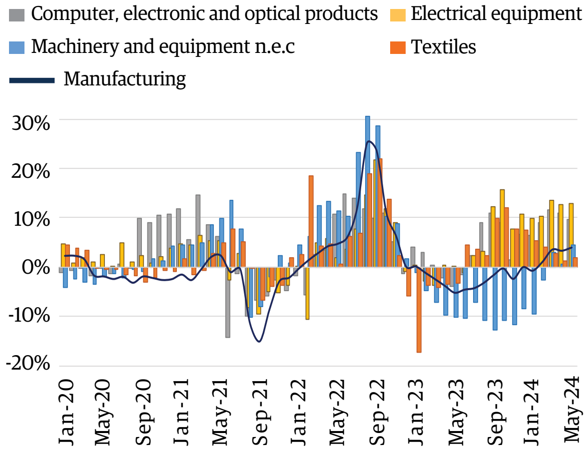


Source: GSO and World Bank staff calculations

Manufacturing employment ticked up to 4 percent (y/y) in May 2024, after a decline in 2023 marked by falling manufacturing production (especially machinery) due to weaker external demand. The recent surge in employment is underpinned by job creation in electronics and electrical equipment, while the textile sector – a traditional harbor of manufacturing employment – shows signs of easing (1.9 percent (y/y), -5.5pp compared to December 2023) (Figure 1.12). Industrial output has consistently grown at a faster rate than employment since February 2023. Current manufacturing output growth reached 11.9 percent (y/y) in May 2024 compared to 4 percent (y/y) for manufacturing employment, suggesting significant productivity gains. While this gain partly reflects a lag in recovery of employment, its size and sustained nature over nearly 18 months point to more permanent productivity increases from a low floor and an increase in commodities production[6] (Figure 1.13).

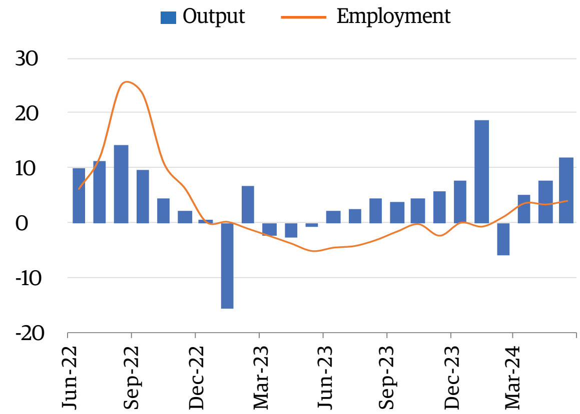
[6] Labor productivity measures are not available at a monthly or quarterly frequency. In 2023, labor productivity in manufacturing – as measured by output per number of employed workers – climbed by 2.4 percent, representative of VND 204.2 million per worker (US$8,000). Labor productivity has historically been low in Viet Nam compared to regional peers such as Indonesia, the Philippines and Thailand.

Figure 1.12. Manufacturing employment growth driven by electronics and electrical equipment
Percent (y/y)



Source: GSO and World Bank staff calculations

Figure 1.13. Manufacturing output growth overtaking employment to create productivity gains
Output and employment in manufacturing
Percent (y/y)



Source: GSO and World Bank staff calculations
Note: Employment is the number of active workers in industrial firms on the first day of the month. Output is the IPI

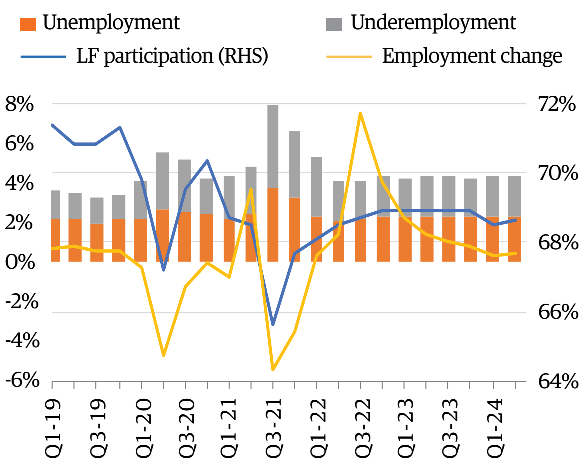
But overall, total formal employment remained flat and real income growth was modest

Formal employment was flat, with a smaller post-pandemic labor force. By April 2024, there were 51.5 million Vietnamese employed (+0.4 percent (y/y)). Labor force participation sat at 68.6 percent in June 2024 (Figure 1.14), remaining relatively stable over the past two years, but below 2019's level of 71.1 percent partly due to measurement and structural changes affecting the agricultural population.[7] Employment changes remained negligible with unemployment and underemployment rates stabilized at 2.3 and 2.1 percent (y/y), respectively in June 2024. Underemployment remains higher than before the health crisis, suggesting more partial employment and plausibly higher informality rates.

Real income growth also remained subdued, weighing on domestic consumption. Domestic consumption contributed about 64 percent of GDP growth in 2024. Average monthly earnings of VND 7.45 million (US$293) in June 2024 correspond to 7 percent growth (y/y), or 2.5 percent (y/y) in real terms. Real income has been muted since 2022, inching up 2.7 percent annually on average, below pre-pandemic trends (11.9 percent annual growth in nominal terms, and 8.4 percent in real terms), which is weighing on domestic consumption (Figure 1.15).

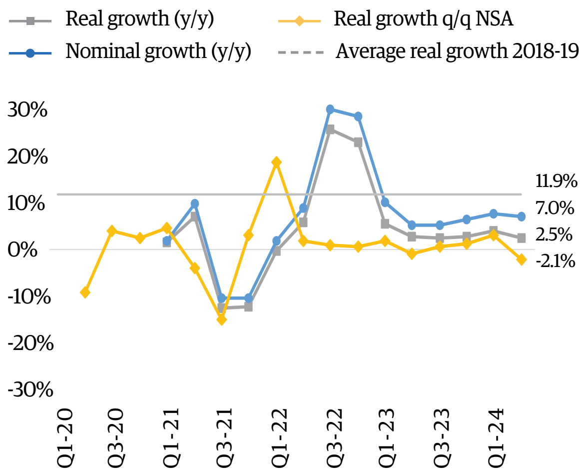
[7] A change in survey definitions in 2021 means subsistence farmers are no longer categorized as being in the labor force, partly causing a shrinkage in the agricultural labor force by 1.8 million between 2020-21. Labor force growth has also reduced across all sectors compared to pre-COVID periods (see World Bank Poverty and Equity Update 2024 for more details).

Figure 1.14. Overall employment remains stable
Percent (y/y)



Source: GSO and World Bank staff calculations

Figure 1.15. Earnings growth is muted



Source: World Bank staff calculations and Haver Analytics

There are signs of recovery in the real estate sector, but uncertainty remains

The real estate market is showing signs of recovery, but investors remain cautious. The supply of newly licensed projects and apartment units flattened in Q1-2024 compared to Q4-2023 as issues such as land clearance and land compensation process remain unresolved (Figure 1.17). More attractive mortgage rates for new loans bumped up the number of transactions by 22 percent q/q in Q1-2024 from a low base (Figure 1.16). However, investor confidence remains low, and the sector faces financial risks as NPLs to developers and home buyers increased to an estimated 2.73 percent of all loans in 2023, up from 1.7 percent in 2022, according to the SBV. The current number of transactions remained only 20 percent of the annual average before the pandemic (2018–19), according to the Viet Nam National Real Estate Association.

The Vietnamese authorities are taking several steps to support the real estate sector recovery. Implementation of key revised laws was advanced to August 2024 from January 2025, including the Real Estate Business Law, Viet Nam Housing Law, and Land Law. Notable legal amendments include: (i) reducing the maximum level of early deposits for future housing projects, from 70 to 50 percent of the total purchase amount, to ease upfront financing pressures on prospective homeowners, (ii) requiring public disclosure of project information before sales to improve market transparency,[8] and (iii) facilitating the land clearance and compensation process through annual fair market assessments of land. In addition, mortgage rates for new loans have decreased, in response to the SBV's four rate cuts in 2023, thereby partially supporting demand for real estate.

[8] In the past, projects were commonly for sale without complete approvals or full information, commonly resulting in violations and disputes. The new 2023 Real Estate Business Law stipulates clear guidelines on disclosure, such as land use rights and project purposes, thereby improving transparency and consumer protection.

Figure 1.16. More attractive mortgage rates for new loans pushed up transactions
Number of real estate transactions

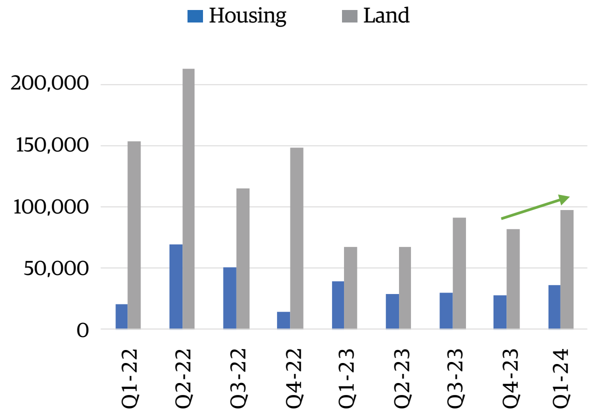
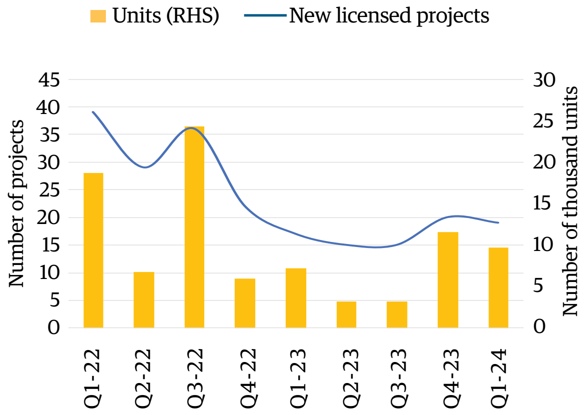


Figure 1.17. Supply of newly licensed projects and apartment units flattened
New housing projects



Source: Ministry of Construction

Despite positive current account and financial account balances, Viet Nam's external position deteriorated due to increased informal capital outflows

The current account remained in surplus during Q1-2024 compared to Q1-2023 with a larger trade surplus balancing a high primary income deficit (Figure 1.18). The current account registered a surplus of 5.1 percent of GDP in Q1-2024 compared to 2.1 percent in Q1-2023. The merchandise trade surplus increased from 8.7 percent of GDP in Q1-2023 to 11.7 percent in Q1-2024 due the strong 17.1 percent (y/y) rebound of exports in the first three months of 2024, while imports grew by 12.9 percent (y/y). The net primary income deficit was 7.5 percent of GDP in Q1-2024 comparable to 7.7 percent in Q1-2023.

Despite steady FDI inflows, the financial account registered a smaller surplus in the first quarter of 2024 compared to Q1-2023 driven by higher net outflows (Figure 1.19). FDI was steady at 3.4 percent of GDP in Q1-2024 comparable to Q1-2023, thanks to continued foreign investors' confidence in Viet Nam's economic prospects and the ongoing relocation of supply chains across the region. Portfolio investment registered a net outflow (0.5 percent of GDP in Q1-2024 compared to a net inflow of 0.3 percent of GDP in Q1-2023) as foreign investors realized gains on their investments.

Figure 1.18. The current account remained in surplus
Percent of GDP

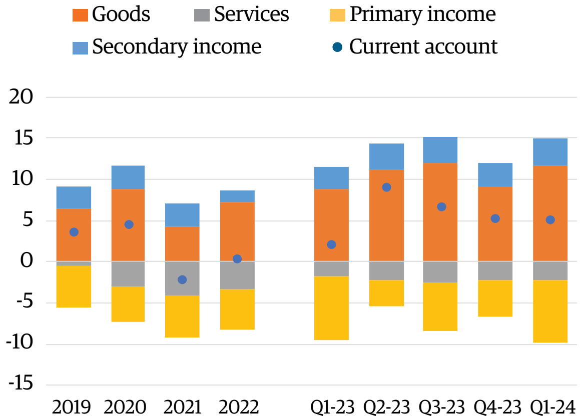
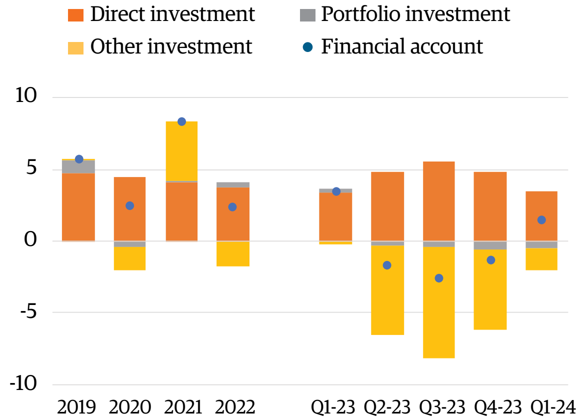


Figure 1.19. The financial account registered a small surplus driven by higher net outflows
Percent of GDP



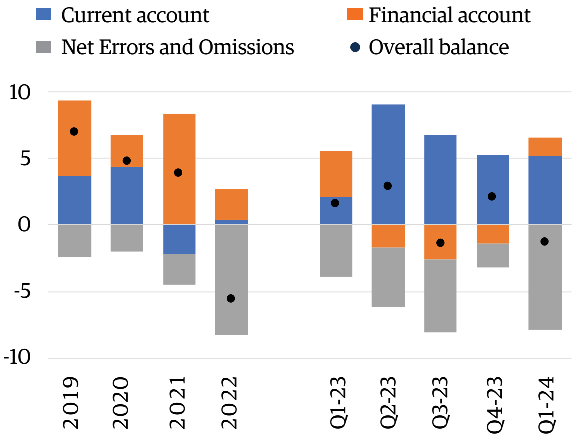
Source: SBV and World Bank staff calculations
Note: Annual GDP for 2019-22, and quarterly GDP for 2023-24 as denominator

Continued VND-US$ interest rate differentials and the global strengthening of the US dollar increased informal capital outflows in Q1-2024. Despite recent increases in overnight interest rates in Viet Nam, the gap between the two currency overnight rates remained substantial (166bps) in the first half of 2024, exacerbating capital outflows from investors in search of better yields. Moreover, the VND-US$ exchange rate had weakened from VND 24,258 in December 2023 to VND 24,760 by the end of March 2024, putting pressure on the local currency and raising concern about potential further depreciation. Seeking other investment instruments, the domestic demand for gold spiked (+28.6 percent (y/y)) which, combined with supply controls, led to substantial price premiums fueling informal gold imports and purchases. As a result, net errors, and omissions, which include unrecorded capital outflows, quadrupled from 1.9 percent of GDP in Q4-2023 to 7.9 percent (- US$8 billion) in Q1-2024, much higher than the average of 2.5 percent of GDP over 2017-19. This led to a small Balance of Payment deficit (- US$ 1.37 billion) in Q1-2024, despite current accounts and financial accounts being in surplus (Figure 1.20).

In response, the SBV allowed for a gradual depreciation of the VND-US$ exchange rate while withdrawing liquidity and selling foreign reserves. The SBV depreciated the central rate by 1.2 percent between January and June 2024, allowing the market rate to depreciate further by 3.6 percent in the same period (Figure 1.21). It used foreign exchange interventions to mediate depreciation pressures against the dong. By the end of June 2024, foreign exchange reserves are estimated to have fallen from US$90 billion in December 2023 to around US$83-84 billion, equivalent to 2.7 months of imports (Figure 1.23). In addition, the SBV began withdrawing liquidity from the interbank market in mid-March 2024, by issuing a higher SBV bill rate (4.25 percent). This bumped up the average overnight interbank interest rate from 0.9 percent in March 2024 to 4.25 percent in May 2024, before decreasing to 2.8 percent in June 2024 (Figure 1.22). This interbank interest rate increase eased pressure on the local currency.

Figure 1.20. Large unrecorded capital outflows generated a negative external position despite positive current and financial account balances

Percent of GDP

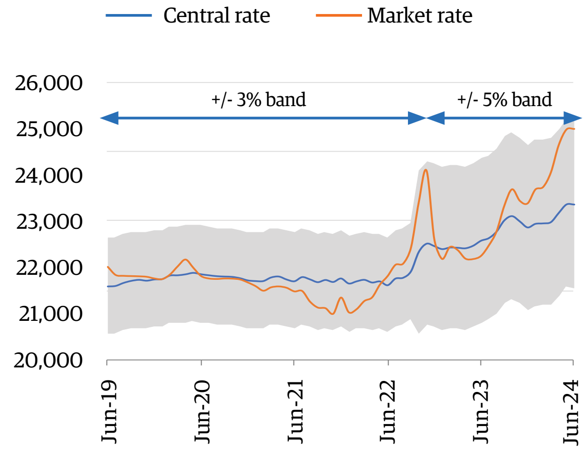


Source: SBV and World Bank staff calculations

Note: Annual GDP for 2019-22, and quarterly GDP for 2023-2024 as denominator.

Figure 1.21. Continued pressure on the exchange rate led to depreciation

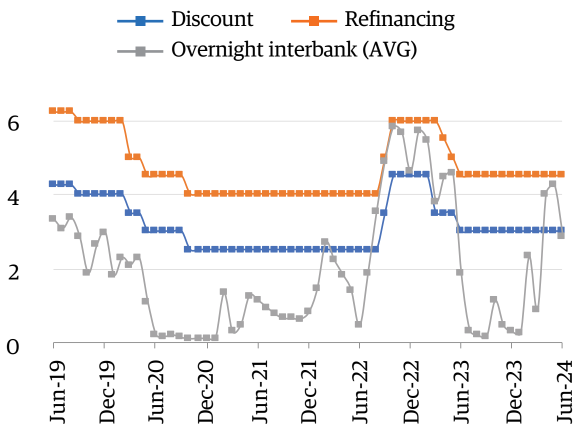
VND/US$



Source: Haver Analytics and World Bank staff calculations

Figure 1.22. Interbank interest rate increased as the SBV withdrew liquidity

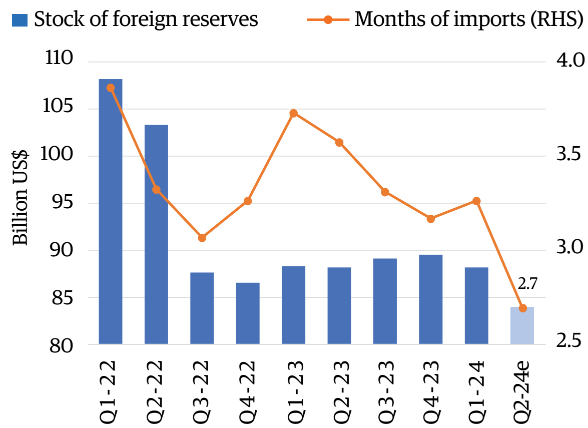
Percent



Source: Haver Analytics

Figure 1.23. SBV managed a gradual depreciation by selling foreign reserves

Billion US$/months of imports



Source: SBV, Haver Analytics and World Bank staff calculations

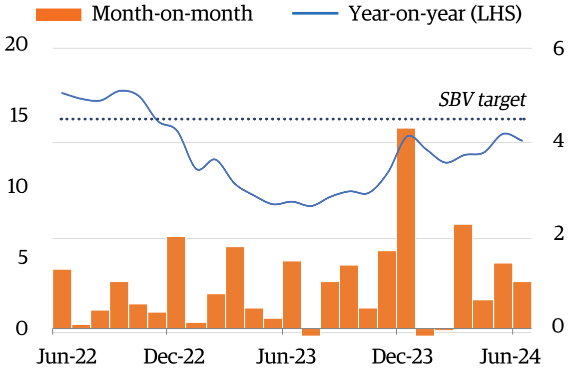
The financial sector showed signs of recovery

Credit growth improved but remained below the SBV's target of 15 percent for the year despite a favorable interest rate environment, reflecting continued weak domestic investment demand. By the close of June 2024, credit growth hit 13.5 percent (y/y), driven by manufacturing, real estate, and trade, transport and telecommunications[9] (Figure 1.24). The latest data on consumer loans from banks,

[9] Fiingroup Research. Data for Q12024 (year-to-date) shows credit growth for manufacturing (3%), real estate (2.1 %), and trade, transport and telecommunications (1.5%) as main contributors to overall credit growth.

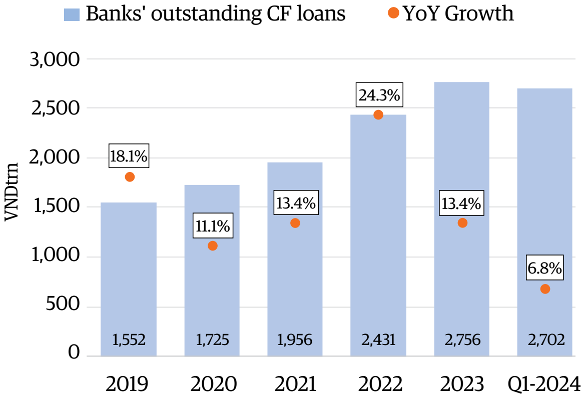
which represent 95 percent of total consumer loans[10], suggests that consumer sentiment remained weak as evidenced by the decline in homebuying and auto loans in Q1-2024 compared to the end of 2023. Total consumer loans grew by 6.8 percent (y/y) in Q1-2024, on the back of soft growth in 2023, lower than the average (y/y) growth rate of 16.1 percent in the previous five years (Figure 1.25).

Figure 1.24. Credit growth improved, but remained below target
Percent



Source: SBV, Haver Analytics and World Bank staff calculations

Figure 1.25. Consumer sentiment remained weak
Consumer loans, trillion VND



Source: Fiingroup Research

Headline inflation had climbed 4.3 percent (y/y) by June 2024, while core inflation eased to 2.6 percent (y/y). Food price increases were the largest contributor to the CPI increase, representing 1.5pp of headline inflation in June (+0.8pp since January 2024) as pork prices rose sharply due to outbreaks of African swine fever in some localities triggering a cull of 42,400 infected pigs in 2024, a five-fold increase compared to the same period last year.[11] Government-administered prices in health and education also rose 0.6pp (+0.2pp since June 2023) due to the application of new medical service prices.[12] Core inflation (excluding food, fuels, and government-administered prices) continued declining to 2.6 percent (y/y) in June 2024 from 4.3 percent (y/y) in June 2023 (Figure 1.26).

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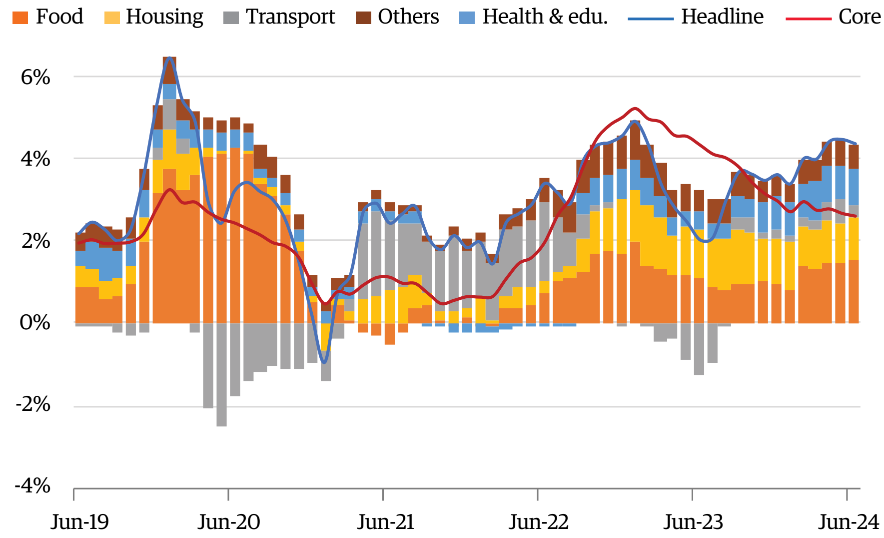
[10] Fiingroup Research. 2024.

[11] The price of live pigs in southern Viet Nam reached VND 65,000 (US$2.6) per kilogram in July 2024, a 30 percent increase since January 2024, while prices of chickens and ducks remained stable (Source: Chan Nuoi Viet Nam).

[12] Circular No. 22/2023/TT-BYT (November 17, 2023) on prices for medical examination and treatment services covered by health insurance among hospitals nationwide.

Figure 1.26. Elevated food prices contributed to higher inflation
Percentage points (y/y)

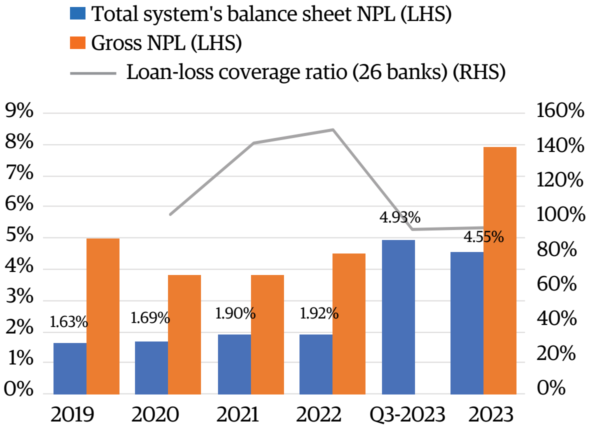


Source: GSO, Haver Analytics and World Bank staff calculations
Note: Food includes grain, foodstuff and food consumption outside home; housing includes rent, utilities (electricity, water, fuel) and construction materials

Asset quality has remained a significant banking sector concern since 2023, amid increasing NPLs and loan-loss coverage. System-wide on balance sheet NPLs have grown significantly, from 1.9 percent in 2022 to 4.6 percent of total loans in 2023 (Figure 1.27), based on the latest available data, driven by the recognition of bad debts held by Saigon Joint Stock Commercial Bank (SCB). However, total problem loans could be as high as 7.9 percent if restructured loans and Viet Nam Asset Management Company (VAMC) debts are included. Latest Q1-2024 data suggests that the NPL ratios of 27 listed commercial banks, which account for 83 percent of total outstanding credit in the banking sector, rose from 1.9 percent in Q4-2023 to 2.2 percent in Q1-2024, amid rising bad debts coupled with sluggish credit growth. In addition, the expiration of pandemic forbearance measures, set to end in December 2024, may further increase NPL levels. Provisions for loan losses remain uneven among banks and in some cases, insufficient against rising bad debts. The potential need to increase provisioning, adding loan-loss reserves, is placing additional pressure on bank profitability already squeezed by a slowdown in net interest income, fees, and commissions.

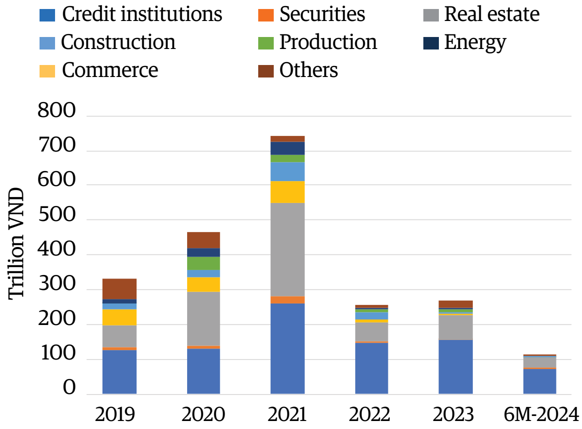
Issuances of corporate bonds are recovering, but bond payment pressures remain high. Bond issuances sharply increased by 2.5-fold in H1-2024 compared to the same period in 2023, driven by banks (Figure 1.28) taking advantage of the lower interest rate environment to refinance bonds. In total, the banking and real estate sectors were the most active issuers, accounting for 64 and 26 percent of total issuances in H1-2024, respectively. However, bonds maturing in the second half of 2024 are estimated at VND 139.8 trillion (US$5.6 billion), of which 42 percent are real estate bonds, placing the property sector under pressure amid cash flow challenges.

Figure 1.27. NPL and loan-loss coverage ratio remained significant concerns
Percent



Source: Fiingroup Research. Note that 2023 gross NPL is an estimation

Figure 1.28. Bond issuance sharply increased driven by banking sector
Trillions VND



Source: VBMA and World Bank staff calculations

Amid the economic recovery, the fiscal balance registered a large surplus in the first half of 2024

The large fiscal surplus of 4.2 percent of GDP in H1-2024, compared to 1.5 percent in H1-2023, was due to higher total revenues and reduced public spending (Figure 1.29). Revenues climbed to 19.5 percent of GDP in H1-2024 (+1pp compared to H1-2023), driven by higher capital revenues (from land sales) and larger tax revenues (from CIT and VAT) (Figure 1.30). At the same time, public spending slowed by 1.6 percentage points from 17 percent of GDP in H1-2023 to 15.4 percent in H1-2024, due to lower public investment disbursement (4.5 percent of GDP in H1-2023 to 3.7 percent in H1-2024) as well as cost-cutting in recurrent expenditures (50 percent of planned recurrent expenditures in H1-2023 to 40 percent in H1-2024). Planned annual savings in recurrent expenditures are earmarked to finance the civil service salary reform agenda, including a substantive wage bill increase from July 1, 2024 (on average, 30 and 15 percent increases in salary base and pensions, respectively).[13] By the end of June 2024, only 29 percent of the National Assembly's approved budget for 2024 was implemented, with public investment disbursement 6 percent lower than the same period in 2023. Slow capital disbursement was attributed to delays in land clearance and compensation for major national highway projects, scarcity of backfill materials (stone and sand), and fluctuating prices of raw materials. In addition, regulatory hurdles and lengthy approval procedures continue to slow implementation of public investment projects. The large fiscal surplus in H1-24 led to less financing needs. Over the first six months of 2024, total bond issuances reached VND 156.5 trillion (US$6.4 billion), equivalent to 39.1 percent of the annual plan, a significant slowdown compared to VND 179.9 trillion or 45 percent of that planned in H1-2023.

[13] Decree No. 73/2024/ND-CP (June 30, 2024) on prescribing statutory pay rate and bonus policies for officials, public employees, and armed forces.

Figure 1.29. Increased fiscal balance surplus due to higher revenues and reduced spending
Percent of GDP

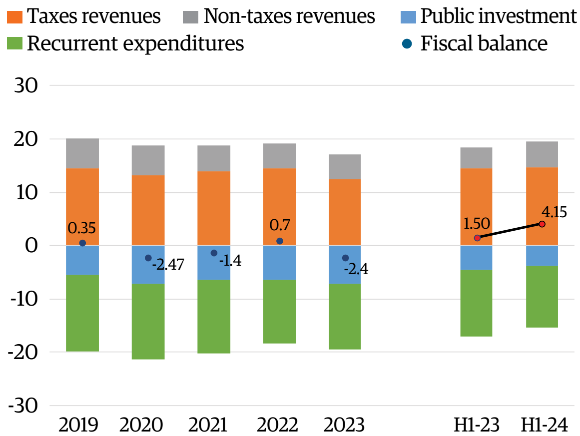
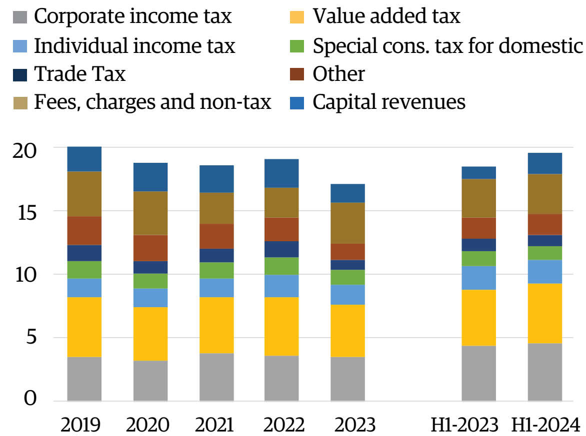


Figure 1.30. Public revenues increased mainly driven by higher capital revenues
Percent of GDP



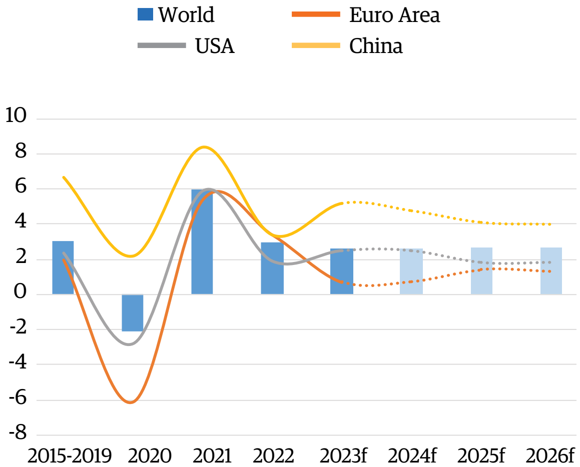
Source: MoF and World Bank staff calculations
Note: Annual GDP for 2019-23, and quarterly GDP for 6M-2023 and 6M-2024 as denominator

II. Economic Outlook, Risks, and Policy Implications

Viet Nam's economic growth prospects are positive

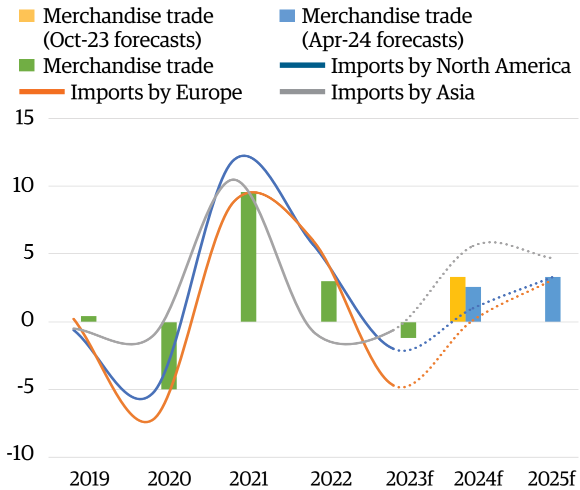
Viet Nam's economy is forecast to grow by 6.1 percent in 2024 and rising to 6.5 percent in 2025-26 (Table 1.1). This projection assumes an easing of manufacturing exports growth in H2-2024, after a 16.9 percent rebound growth (y/y) in H1-2024 and the expected moderation of global demand in 2024, in particular from the United States, Viet Nam's largest export market. Export growth is expected to firm up moderately over 2025-26 as global trade prospects and external demand from major trade partners such as the United States, Euro zone, and China improves slightly (Figures 1.31 and 1.32, Box 1.1). The real estate market is showing signs of recovery and is forecast to turn the corner in late 2024 and into 2025 as the corporate bond market freeze has eased and the Land Law came into effect from August 2024. With continued export growth and signs of a real estate recovery, domestic demand is set to firm up in H2-2024 as investor and consumer sentiment improves, with total real investment and real private consumption expected to grow by 5.8 and 5.6 percent in 2024, respectively.

Figure 1.31. Global GDP growth
Percent (y/y)



Source: Global Economic Prospects, June 2024, World Bank

Figure 1.32. Global goods trade growth
Percent (y/y)



Source: WTO forecasts, April 2024

Box 1.1 Global economic developments and outlook[14]

The global economy is stabilizing after years of overlapping negative shocks. Despite elevated financing costs and heightened geopolitical tensions, global activity firmed in the first half of 2024, underpinned by solid activity in major economies. Global growth is projected to reach 2.6 percent in 2024, a 0.2pp upward revision compared to January 2024. Recent global industrial production growth has generally improved, including global PMIs which have trended up and signaled expansionary activity around the middle of the year. Global trade is also showing signs of recovery, supported by an uptick in goods trade, after stagnant growth in 2023—recording its worst outcome in the past 50 years outside global recessions. However, leading indicators point to softness in trade in the near term, with the new export orders component of the global manufacturing PMI edging into contractionary territory in June. Global headline inflation continues to wane, averaging 3.5 percent in 2024 and making progress toward central bank targets, albeit at a gradual pace, as core inflation has remained stubbornly high in many economies. In tandem, interest rates have been cut in some economies, but not in the United States given resilient activity and above-target inflation.

The global outlook remains subdued reflecting the lagged effects of monetary tightening, resumed fiscal consolidation, and moderate consumption growth (World Bank 2024a). Investment growth is also expected to remain subdued in 2024, constrained by elevated real interest rates and policy uncertainty amid elevated geopolitical tensions. Global growth is forecast to edge up slightly in 2025-26 to 2.7 percent, nearly half a percentage point below the 2010-19 average, as inflation gradually subsides, policy interest rates decline, and trade growth firms up. Following weakness in 2023, trade growth is expected to pick up to 2.5 percent in 2024, well below pre-pandemic averages, and then to 3.4 percent in 2025 and 2026. Assuming no escalation of ongoing

[14] Based on World Bank's Global Economic Prospects (June 2024) and World Bank's Commodity Markets Outlook (April 2024).

conflicts, overall commodity prices are forecast to decline only slightly in 2024 and 2025 and remain well above pre-pandemic levels (World Bank 2024b).

Risks to the global outlook remain tilted to the downside, stemming particularly from the possibility of tighter-than-expected global financial conditions, and further trade fragmentation. Monetary easing in advanced economies could be further delayed if progress returning inflation to targets slows. An intensification of geopolitical tensions and trade policy fragmentation could weigh on global trade activity and weaken global sentiment. With elections taking place in many countries in 2024 and the potential for more inward-looking policies, trade policy-related uncertainty remains elevated. A further key downside risk concerns an escalation in armed conflict which could push up commodity prices, stoking still elevated global inflation. In contrast, faster-than-expected growth in the United States, supported for example by higher labor force participation or immigration, poses an upside risk to the outlook).

In Viet Nam, headline inflation is forecast to continue rising in 2024 to 4.5 percent, up from 3.2 percent a year earlier, as higher food prices are expected to persist. This forecast reflects the recent surge in food prices, contributing most to recent inflation in H1-2024, and expected to continue to rise as African swine fever outbreaks spread nationwide despite measures to strengthen control and prevention.[15] Despite continued conflicts in Ukraine and the Middle East, oil and commodity price inflation is projected to continue easing over 2024. The increase in public wages and pensions in July 2024 is expected to have a marginal impact on headline inflation given the limited size of the public sector in overall employment (two million, 3.8 percent of total employment[16]). Over the medium term, inflation is forecast to return to its historical average of 3.5 percent.

The current account is projected to maintain a surplus in 2024, primarily driven by the merchandise trade balance. The current account balance is projected to register a small surplus in 2024-2026, driven by the continued growth in goods exports, with contributions from tourism and transport services. FDI inflows are expected to remain stable in the short- to medium-terms, reflecting foreign investors' sustained interest in Viet Nam.

The government is expected to resume fiscal consolidation as the economy returns to a higher growth path. The fiscal deficit is projected to shrink to 0.8 percent of GDP in 2024, and narrow further to 0.5 and 0.1 percent of GDP in 2025 and 2026, respectively, as tax revenue expenditure-based fiscal consolidation resumes in 2024. In the next two years, recurrent expenditures will continue to be rationalized based on the ongoing five-year fiscal plan. Improved domestic revenue collection is also projected to support consolidation thanks to a buoyant tax base, while the revisions of major tax laws (VAT and CIT) and improvements in tax administration will help increase revenue collection.

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[15] African swine fever is a highly contagious viral disease affecting pigs and wild boar, with up to a 100 percent case fatality rate. By July 14, 2024, some 660 outbreaks had been detected compared to 208 in the same period in 2023, with 42,400 infected pigs culled in 2024, five-fold higher than the same period in 2023. The Vietnamese authorities announced an increase in priority funds to reduce the spread of the disease, including for the vaccination of pigs.

[16] Viet Nam, MOLISA, 2023 labor data.

Table 1.1. Selected economic indicators, Viet Nam 2021-26

Indicator	2021	2022	2023	2024e	2025f	2026f
GDP growth (%)	2.6	8.0	5.0	6.1	6.5	6.5
Growth of expenditure components						
Private consumption	2.0	7.8	3.5	5.3	5.9	5.9
Public consumption	4.7	3.6	4.9	5.5	5.4	5.4
Investment	3.7	5.8	4.1	6.8	7.0	7.2
Exports	13.9	4.9	-2.5	11.4	7.4	8.0
Imports	15.8	2.2	-4.3	11.7	7.0	7.7
Consumer Price Index (average, %)	1.8	3.1	3.3	4.5	4.0	3.5
Current account balance (% of GDP)	-2.2	0.3	5.8	0.9	1.0	1.0
Fiscal balance (*) (% of GDP)	-1.4	0.7	-2.4	-0.8	-0.4	-0.2
Public & publicly guaranteed debt (**) (% of GDP)	42.5	37.1	36.0	35.7	35.0	34.6

Source: GSO; MoF; SBV; IMF; and World Bank staff calculations.

Note: e = estimate; f = forecast, *: excluding unallocated expenditures and following Government Finance Statistics (GFS), **: calculated based on Decision No. 458/QD-TTg (April 28, 2023) related to the plan for borrowing and repaying public debt in 2023 and for 2023-25, Resolution No. 105/2023/QH15 (November 10, 2023) related to the government's 2024 budget.

Risks to the outlook are broadly balanced

This outlook is subject to external and domestic downside risks. Given Viet Nam's openness to the global economy, the main uncertainty stems from slower-than-expected global growth, particularly among major trading partners such as the United States, European Union, and China. Such developments could impact Viet Nam's manufacturing exports and that of industrial production and growth by extension. An escalation of geopolitical tensions could additionally affect exports. Domestically, if macroeconomic stability were to weaken, consumer confidence could erode further, affecting consumption and investment. The real estate market recovery could take longer than expected, adversely impacting private sector investment, an important contributor to economic growth. If the financial sector's asset quality were to weaken further, bank lending capacity could be undermined. As one of the world's most vulnerable countries to climate change, increasingly intensifying natural disasters pose additional downside risks. Energy supply shortages could hamper the growth of manufacturing exports, as the country remains exposed to heatwaves affecting hydro power plants in northern Viet Nam, although the planned completion of a 500kV transmission line across the country in the summer of 2024 could reduce this risk.

This outlook could also be subject to potential upside developments. Stronger-than-expected global growth could spur a faster recovery of Viet Nam's export sector. Higher growth in the United States and European Union, particularly in consumption, could lead to stronger demand for Vietnamese exports than forecasted. Accommodative monetary policy in major advanced economies, already initiated by the European Central Bank and the Bank of England, along with the U.S. Federal Reserve signaling a possible rate cut by September, could further boost Vietnamese exports. This would also contribute to an easing of global financing costs and close the VND-US$ interest rate gap, with potential positive spillovers into the banking and financial sector in Viet Nam.

Policies to support the growth momentum

Given the economy is not yet back to its pre-pandemic growth path, accelerating disbursement of public investment would support aggregate demand in the short run, while also helping to close emerging infrastructure gaps. An increase in public investment by one percentage point of GDP could lead to a rise in GDP of 0.1 percent.[17] On the other hand, monetary authorities continue to face limited room for additional interest rate cuts due to existing large interest rate differentials between domestic and international markets and the pressure it could bear on the exchange rate.

Building on recent reforms, further steps to mitigate financial sector risks and vulnerabilities remain crucial. The authorities could encourage banks to improve capital adequacy ratios and strengthen the institutional framework for prudential supervision (including to detect and address issues arising from the affiliation of banks with business groups) and early interventions (early identification of problems and prevention of fully blown crises). While the Law on Credit Institutions was enhanced with a recent amendment, gaps remain in some areas including consolidated supervision on a group basis, particularly of banks affiliated with the real sector. Other areas for improvement include bank resolution and crisis management, as well as legal protection of supervisors. For example, the SBV does not have a full range of resolution powers and tools to deal with non-viable banks. Strengthening the SBV's mandate in these areas should be a priority in upcoming financial sector legal reforms, including through amendment of the Law on State Bank of Viet Nam.

Finally, structural reforms are crucial to sustain long-term growth prospects. Beyond providing short-term stimulus, enhanced public investment management is also key to addressing emerging infrastructure gaps - for example in energy, transport, and logistics - which are becoming a growing constraint on growth. In parallel, the authorities should accelerate structural reforms to strengthen the regulatory environment in critical backbone services (information and communication technology, electricity, transport), to green the economy, build human capital and improve the business environment. Further trade diversification (destination and products) and deepening regional trade integration and connectivity will also reduce exposure to global trade fragmentation and ensure more resilient growth. In addition, a greater integration of the domestic private ecosystem into global supply chains (increasing the share of domestic suppliers by FDI firms) would ensure greater contributions from trade integration in Viet Nam.

[17] World Bank staff calculations.

Chapter 2

Reaching New Heights in Capital Markets[18]

I. Introduction

Viet Nam is already one of the fastest-growing economies in the world with the ambitious goal of becoming a high-income nation by 2045. To realize this objective, Viet Nam will need to grow its real GDP by about 6.5 percent annually over the next 20 years and increase its total investment, currently at 32 percent of GDP (about US$131 billion).[19] This ambitious objective remains within reach, as Viet Nam's economy grew at more than 6.5 percent on average annually over 2010–19 and has rebounded fast since the COVID-19 pandemic.

Achieving high-income status will require increased financing for long-term projects – especially in infrastructure and the climate transition – with additional needed resources estimated at 7 percent of GDP for infrastructure projects alone.[20] With Viet Nam's 2023 GDP, this amounts to US$30 billion per year. Public investment will only provide part of the required financing (one-third for climate investments), with the remainder to be financed by the private sector. Aside from physical infrastructure, significant long-term financing mobilized through capital markets will also be essential for climate change adaptation and decarbonizing the economy, and for the development of digital infrastructure.

Well-functioning capital markets are critical to mobilize resources, as part of inclusive, resilient, and modern financial markets. Healthy capital markets will be an essential element of Viet Nam's high-income growth strategy. They help mobilize resources for long-term investments and allocate resources efficiently across industries, geographies, and moments in time. They will also help to diversify sources of finance, reducing concentrations of risks in the banking sector.

Viet Nam's capital markets have developed strongly over the past decade, underpinned by robust macroeconomic conditions, but remained nascent. Healthy economic growth, a stable exchange rate, improved fiscal consolidation, controlled inflation, and political stability have positioned Viet Nam's capital markets to catch up with regional peers in terms of their relative size (Figure 2.1).

The performance levels of capital markets can be evaluated through success in intermediating finance. Financial intermediation serves to mobilize resources by connecting economic actors that require financing with those that have savings. Well-developed financial intermediation can help optimize the allocation of economic resources across sectors, geographies, and periods in time. An efficient allocation of resources—important for the economy to achieve a higher growth with scarce resources—requires the proper pricing of assets and investments, an essential component of a well-functioning financial market. Therefore, to evaluate the development of Viet Nam's capital markets, it is critical to look at three main

[18] This chapter is a short version of a report titled "Unlocking the Potential of Viet Nam's Capital Markets," published by the World Bank in December 2023, updated with more recent information and statistics.

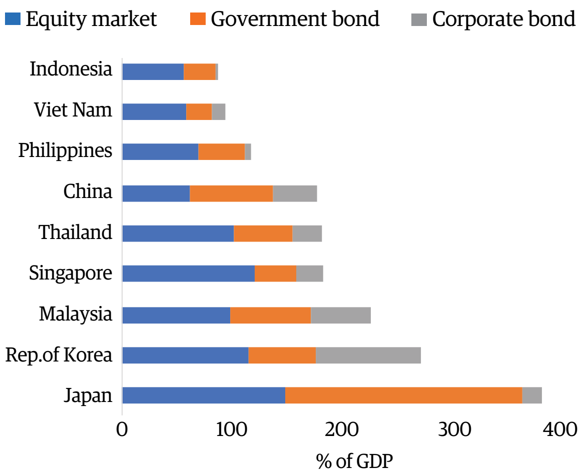
[19] Viet Nam's current (public and private) investment levels represent 32 percent of GDP, below the levels of China and Türkiye, or historical investment ratios achieved by Republic of Korea and Singapore when they reached high-income status (World Bank GVC report, forthcoming).

[20] Diop, M. 2019. "Accelerating Viet Nam's Path to Prosperity." Washington, DC: World Bank. Additional financing needs for the climate transition are estimated at US$368 billion by 2040, or about 6.8 percent of GDP per year (World Bank CCDR 2022).

functions: (i) funding, (ii) savings, and (iii) pricing. On these three measures, Viet Nam's capital markets have significant room for growth.

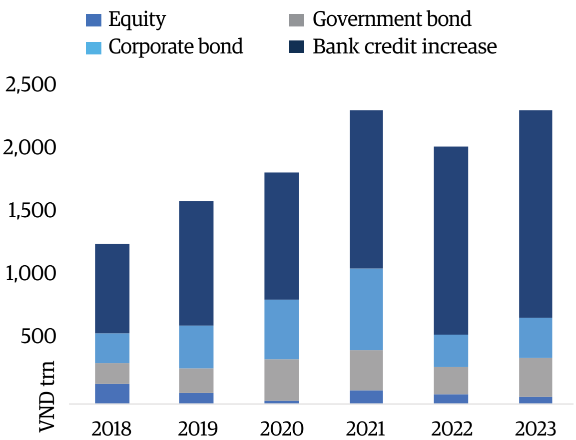
Funding function: **Despite the large equity market capitalization, the amount of funds raised through shares over the past five years has been relatively small,** averaging VND 37 trillion (US$1.5 billion) per year in the two stock exchanges. Bonds were relatively more significant, with an annual average of VND 271 trillion (US$11 billion) and VND 403 trillion (US$17 billion) issued in government bonds and corporate bonds, respectively between 2019 and 2023 (Figure 2.2). Corporate bonds appeared promising with significant growth in issuances until 2021, when peaking at VND 637 trillion (US$26 billion). Yet, the average maturity for corporate bonds is short at around four years, less than half the regional average, reflecting limited long-term financing. Also, recent market turbulence – which saw a significant drop in corporate bond issuances from late 2022 – exposed weaknesses in the market's foundations.

Figure 2.1. Capital market size comparison with peers (2023)



Source: Asian Bonds Online, MoF, countries' stock exchanges and departments of statistics

Figure 2.2. Fund mobilization through capital markets and banks



Source: MoF, FiinGroup, VBMA, authors' calculations

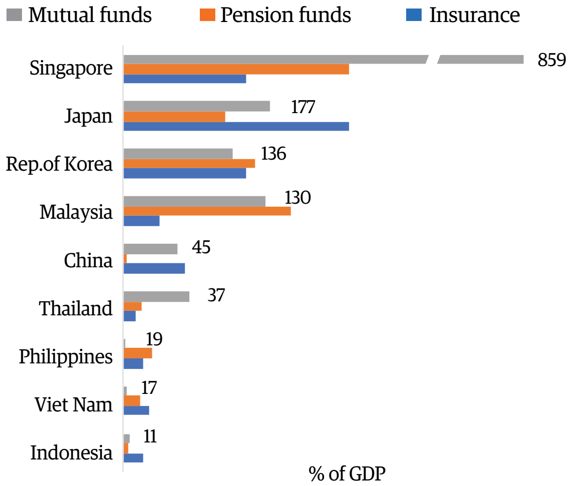
Savings function: **The total amount of savings is still low, limiting the amount available for long-term investments.** In recent years, the number of securities accounts held by individuals has increased, but the total size of Viet Nam's institutional investors remains smaller than most regional peers at 19 percent of GDP (Figure 2.3). This underlines the untapped potential of Viet Nam's capital markets, limiting the provision of long-term financing. Of the existing domestic institutional investors, few invest in the corporate sector.

Pricing function: **While there is an increasing volume of transactions and pricing data, significant gaps remain.** Despite the development of benchmark government bonds, high volatility in interbank rates and differences between these rates and the central bank's policy rates mean the yield curve is not well anchored.[21] Differences are often apparent in government bond prices between auctions

[21] Yield curve represents interest rates at different maturities, i.e., short-term, medium-term, and long-term.

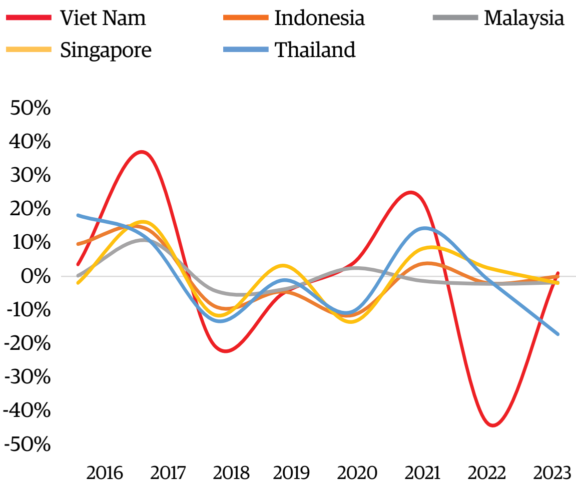
and when traded in the secondary market. Government bond prices are rarely used as a reference for other instruments, such as corporate bonds. In equities, volumes have increased significantly with the total trading value in 2023 reaching VND 7,222 trillion (US$282 billion), but Viet Nam's equity market is the most volatile in the region (Figure 2.4).

Figure 2.3. Institutional investors as percentage of GDP (2023)



Source: Finstat, IMF, World Bank, government agencies

Figure 2.4. Volatility of equity markets in the region



Source: Indonesia Stock Exchange, Bursa Malaysia, SET Index (Thailand), Straits Times Index, and VN Indices, WBG staff

For the capital markets to perform these functions effectively, their interlinked elements must work seamlessly. Policies which affect these market elements must be carefully designed and implemented to unlock significant and impactful long-term capital and channel it into productive sectors of Viet Nam's economy. A concerted effort to develop the capital markets should be a key objective of the government and all stakeholders.

II. Key elements of Viet Nam's Capital Markets

Viet Nam's capital markets are underpinned by six "I"s (I#1-I#6) as illustrated in Figure 2.5.

I#1: Instruments are central to any capital market, as the financial instruments sold in exchange for money. They include valuable papers, bonds (government and corporate bonds), shares, derivatives.

I#2: Investors provide the lifeblood of the capital markets as they have money to invest. They represent the demand side of the markets. The pool of investors is wide, including public, private, domestic, or international investors.

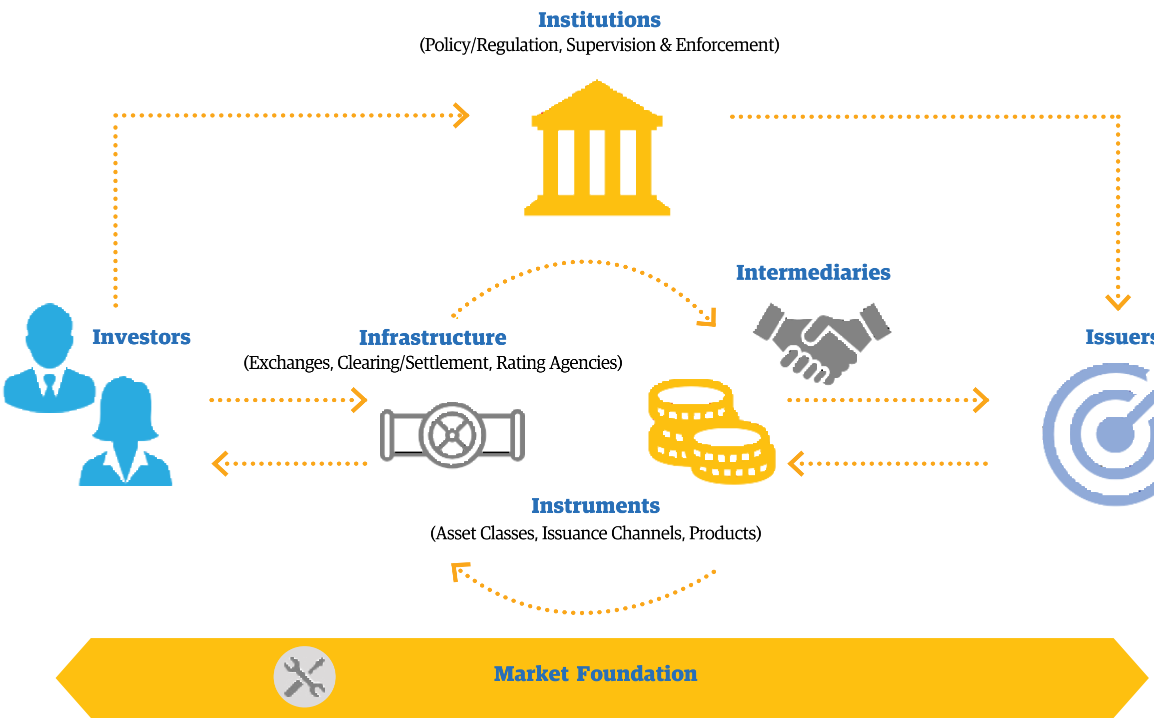
I#3: Issuers are entities which generate and sell financial instruments to raise funds from the investors. Issuers represent the supply side of capital markets. They include government and non-government issuers (e.g. listed companies).

I#4: Intermediaries manage the flow of funding from investors to issuers. They serve as agents for the issuers (who need money) and the investors (who have money). Intermediaries include securities companies and banks.

I#5: Infrastructure refers to the market infrastructure that allows the flow of funds from investors to issuers to take place. Infrastructure not only includes trading and settlement infrastructure (securities exchanges, settlement banks, clearing houses, registrars), but also information infrastructure (rating agencies, data providers).

I#6: Institutions refers to the institutions which regulate and supervise market participants with the primary objectives of achieving market efficiency, protecting investors, and ensuring overall financial market stability.

Figure 2.5. Fundamental framework of Viet Nam's capital markets



Source: WBG staff

1. Instruments

There is a natural hierarchy to capital market instruments, reflecting the way that increasingly complex markets are built upon more fundamental ones (Figure 2.6):

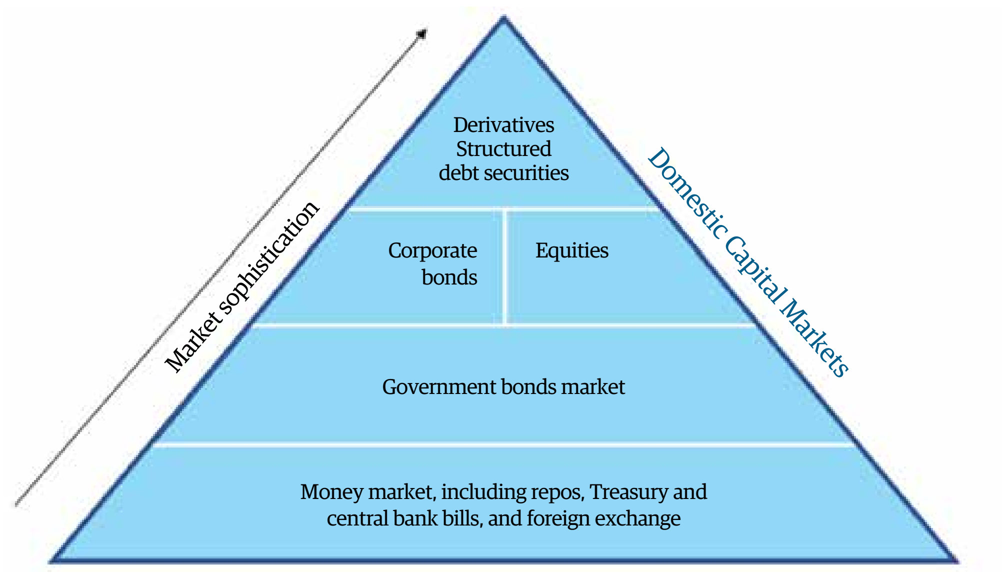
(i) The **money market** is the most fundamental and used to manage short-term liquidity primarily in the interbank market. This market effectively sets the interest rates—that is, the price of money.

(ii) Supported by well-functioning money markets, local currency **government bonds** represent the lowest risk instrument in domestic capital markets, serving as a foundation for pricing of other financial market instruments.

(iii) A well-structured and efficient government bond market provides information that supports the development of a market in securities issued by the private sector, primarily **corporate bonds,** and **equities (stocks).** More complex instruments largely depend on the success of these products.

(iv) Complex instruments include **financial derivatives,** which are legal instruments whose value derives from external references such as interest rates in the money market (interest rate derivatives), bond yields and the prices of equities (bond and stock futures).

Figure 2.6. Natural hierarchy of capital markets



Source: World Bank Group

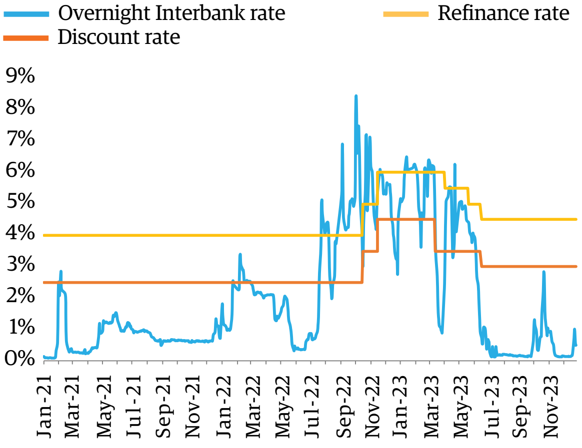
1.1. Money market

The money market requires stronger benchmark rates and standardization

The money market is the first building block for capital markets development. It is a place of exchange for short-term liquidity and is vital for the effectiveness of monetary policy, for setting price references and financial stability. As the first step in the monetary transmission mechanism, it provides price references for the short segment of the yield curve and short-term instruments for banks and others to manage their liquidity. In Viet Nam, the main money market components are the unsecured local currency interbank market, foreign exchange swap market and repurchase ("repo") market. The repo market is especially important for monetary policy transmission and the development of securities markets, as it allows central bank monetary operations to provide or withdraw liquidity from the interbank market through secure collateralized transactions. However, the attractiveness of repos in Viet Nam is constrained by the absence of a widely used standard repo agreement.

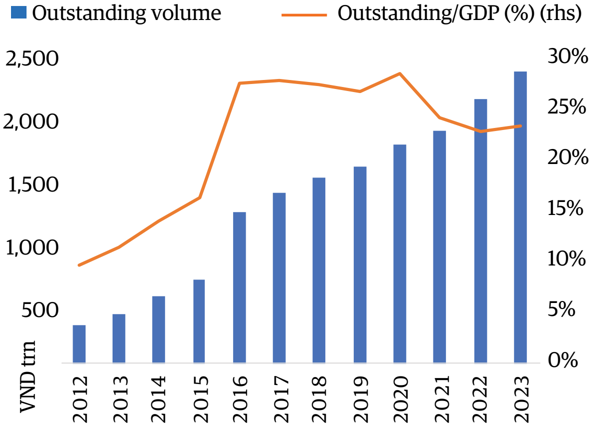
Benchmark interest rates from active money markets should support market development through reduced information asymmetry and improved price discovery, but all available rates in Viet Nam have key weaknesses that hinder use as a credible price reference. As refinancing and discount rates published by the State Bank of Viet Nam (SBV) are not sufficiently linked to the market (Figure 2.7), they cannot be used as a pricing anchor for longer-term instruments. The overnight interbank interest rate, compiled and published by the SBV, is a candidate to become a widely used transaction-based benchmark rate if strengthened in line with the Principles for Financial Benchmarks of the International Organization of Securities Commissions (IOSCO). Meanwhile, daily short-term rates published by the Viet Nam Bond Market Association (VBMA) are based on quotes in the less liquid repo market, rather than in actual transactions. The Viet Nam Interbank Offered Rate (VNIBOR) is also based on indicative quotes.

Figure 2.7. Short-term money market rate compared to refinancing rate and discount rate



Source: VBMA, FiinGroup

Figure 2.8. Government bond volume and size to GDP



Source: VBMA, Ministry of Finance, Viet Nam

1.2. Government bond market

Addressing challenges in liquidity and pricing distortions is key

An efficient and liquid government bond market is essential to government finances and an important foundation for the development of capital markets. A sound government bond market: (i) provides a solid yield curve and price references for the valuation of financial instruments and development of markets for private sector products, such as corporate bonds, (ii) fosters financial intermediation, makes it easier for the private sector to issue debt, (iii) offers low-risk instruments for liquidity management by financial institutions and for implementation of monetary policy by the central bank, and (iv) makes low-risk investments available to investors. This requires a market based on a well-structured bond portfolio with a wide range of maturities available, supported by reasonable liquidity in the secondary market. Deep and efficient local currency government bond markets also help provide resilience to shocks. The government bond market has become a main source of financing for the Government of Viet Nam, with the market size relative to GDP stabilizing in recent years and annual gross issuances reaching VND 298 trillion in 2023 (Figure 2.8).

Participation of the Viet Nam Social Security Fund (VSS) in government bonds is significant and has enabled the government to focus on issuing long-term instruments. These long-term instruments dominate the issuance profile of government bonds, helping to lengthen the average maturity and protect the government against short-term shocks, including changes in interest rates and investor sentiment. It has been a strategic goal of the Ministry of Finance (MoF) to gradually increase the average maturity of the government bond portfolio. As such, 95 percent of all issuances in 2021 were 10 years or longer in maturity and this hit 100 percent in 2022. Meanwhile the VSS, which manages a large fund for people's pensions and other social benefits with reserves equivalent to 10 percent of GDP, has an appetite for these bonds to offset its long-term liabilities. As a result, the market share of insurance entities, including VSS as a social insurance entity, has steadily climbed to 60 percent (Table 2.1) in the government bond market, with the remainder held almost entirely by banks (40 percent).

Table 2.1. Composition of the investor base in government bonds (%)

Investors	2017	2018	2019	2020	2021	2022	2023
Banks	52.7	47.8	43.9	45.2	41.9	40.5	39.7
VSS and insurers	45.4	50.8	54.7	54.1	57.2	58.9	59.8
Securities companies	0.1	0.0	0.0	0.0	0.1	0.1	0.1
Investment funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-resident	1.2	0.6	0.8	0.6	0.7	0.2	0.2
Other	0.6	0.8	0.7	0.1	0.0	0.3	0.3

Source: Ministry of Finance, Viet Nam

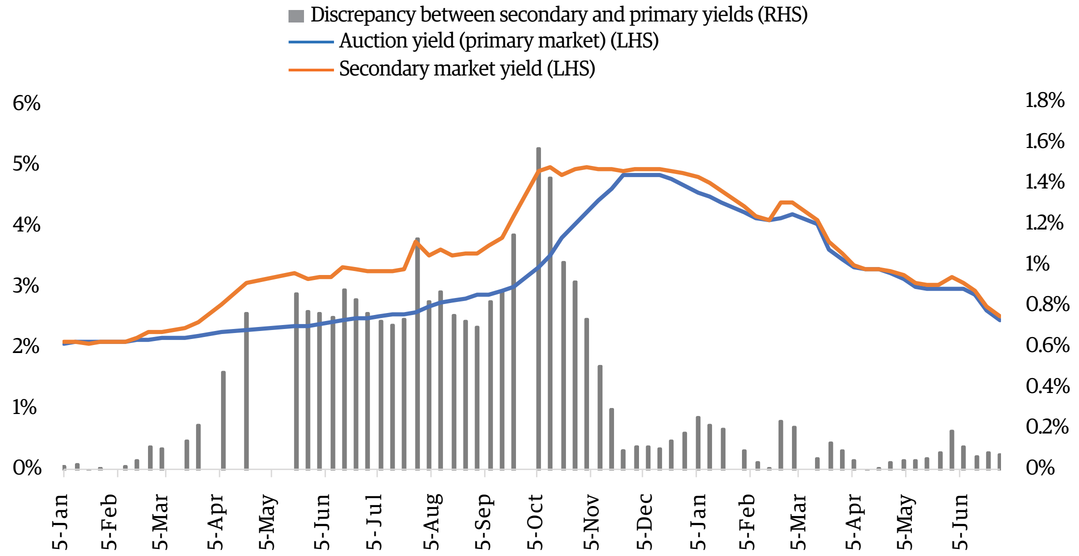
The focus on issuing longer tenor bonds to the VSS, however, has had unintended consequences for bond prices, the yield curve, and secondary market liquidity. Firstly, as VSS is not permitted to invest in anything other than government and state-owned bank instruments,[22] it has become a captive investor for government bonds. This captive status has forced it to buy government bonds even with low yields, with no other way to invest its large reserves (this issue will be discussed further in Section 2.1). Secondly, the concentration in "buy-and-hold" investors like VSS means there is tepid secondary market trading and therefore scant price information. Legal constraints prevent VSS from participating in the secondary market. As a result, there are often price differences between the primary and secondary markets (Figure 2.9). In its attempt to keep borrowing costs low, the MoF sometimes cancels an issuance if buyers bid at higher yields than its preference, which often occurs when secondary market yields increase. Between January 2020 and December 2023, for example, the MoF rejected all bids in 20 percent of auctions. Cumulatively, these issues contribute to distortions in the pricing functions of the government bond market.

The government bond portfolio is also highly fragmented, as numerous bonds have similar maturity dates. There were 194 government bonds in 2023, reflecting that the average bond size is smaller than potential, leading to sub-optimal liquidity. This has also led to a practice of quoting prices for a group of bonds with similar tenors rather than prices for a specific bond. In this instance, buyers are not guaranteed to receive a specific bond they want, only those that fall into a certain group. This practice, common in Viet Nam, is not aligned with the international market and is likely a significant obstacle for inclusion in international bond indices, such as the J.P. Morgan Global Bond Index. Such inclusion would have a significant upside in increasing the market's attractiveness to international investors and thus broadening the investor base.

To realize government bond market effectiveness in providing a pricing foundation for capital markets, several reforms must be considered. Key reforms include, firstly, VSS investment diversification to escape being a captive investor in government bonds, especially long-tenor ones, at any cost. This would reduce price distortions. Secondly, the government should regularly issue bonds in all key maturity segments—short-, medium-, and long-term—so these tenors are liquid and active, thus providing pricing signals. Thirdly, reducing the number of bonds while increasing the size of each bond would make bonds much more liquid and attractive. Enlarging the bond size would require an effective liability management system by the MoF to mitigate the risk of non-repayment when a large bond repayment is due.

22 A newly amended Law on Social Insurance, approved in June 2024, provides that the government prescribe a roadmap for investment diversification, criteria for investment portfolios, investment structure and investment methods of social insurance funds. However, currently permitted investments remain limited.

Figure 2.9. Primary and secondary market yields on the same tenor
10-year Vietnamese government bond yields



Source: Ministry of Finance, Viet Nam, VBMA, World Bank Staff calculations
Note: In an efficient market, there should be no major discrepancy between primary market and secondary market yields

1.3. Corporate bond market

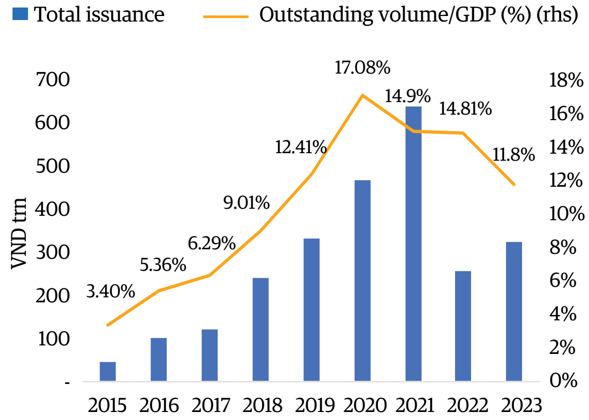
Growth has been hampered by regulatory violations, highlighting the need for enhanced transparency and market professionalism

The corporate bond market was relatively active until mid-2022, when market turbulence simultaneously exposed fundamental weaknesses, yet underscored potential for further growth. Issuances reached a peak of VND 637 trillion (US$28 billion) in 2021 (Figure 2.10), but later dampened due to the crackdown on fraudulent practices in bond issuances by Van Thinh Phat and Tan Hoang Minh real estate groups in 2022.[23] In 2023, the market slowly recovered, representing 12 percent of GDP, compared to a range of 27-105 percent for regional peers.[24] The market has been dominated by private placements, with an average of 23 public offers (VND 24 trillion) compared to 938 private placements (VND 383 trillion) in the last five years (Figure 2.11)—although there was a shift towards more public issuances in 2023, which accounted for 11 percent of total issuances (compared to 3-5 percent in previous years).

[23] Top officers and affiliates at Van Thinh Phat Group, one of the largest real estate conglomerates in Viet Nam, were found guilty of alleged property license misappropriation and fraudulent bond issuance. Similarly, leaders of Tan Hoang Minh Group misappropriated more than VND 8.6 trillion (US$348 million) by illegally raising funds through fabricated businesses.

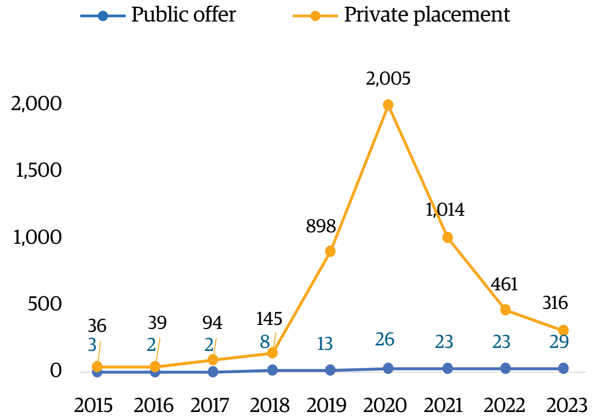
[24] Including Australia, Malaysia, Republic of Korea, Singapore, and Thailand (Source: Asian Bonds Online).

Figure 2.10. Corporate bond issuances and size to GDP



Source: MoF, VBMA

Figure 2.11. Number of corporate bond issuances



Source: FiinGroup, VBMA

Until recently, the focus on private placements created risk for inexperienced investors. A private placement market, by nature, has limited disclosure and protection for retail investors. Therefore, in Viet Nam, the Securities Law limits the market to professional investors. In a well-developed private placement market, true professional investors have the capacity to analyze, evaluate risk, and assign appropriate prices to bonds. Meanwhile, in a public offer market, regulatory approval is needed before bond issuances to ensure proper disclosure. In either case, appropriate checks and balances exist to prevent bad issuers from raising funds in the market. Viet Nam's corporate bond market, however, falls short. Despite the exclusive access of private placement bonds mandated by the Securities Law, weaknesses in the definition of professional investors and in its application have allowed significant sales of private placement bonds to individual investors not equipped to appreciate risks or absorb losses. As a result, when high-profile cases of fraud and misconduct were uncovered in mid-2022, investor confidence was lost, and the market shrunk significantly.

It is critical that authorities continue reforms to stabilize the market and steer its growth in the right direction. Decree No.08/2023/ND-CP created space for the restructuring corporate bonds to prevent larger turbulence impacting financial stability, while Decree No.65/2022/ND-CP introduced more stringent conditions and requirements on private placements of bonds, especially those sold to individual investors, with tightened disclosure requirements. While these steps are positive, further strides are needed to grow the market in a healthy manner. The unfinished agenda includes strengthening the definition of professional investors and its application, expanding the use of credit ratings, encouraging public investment fund growth to pool retail investors and boost market professionalism, optimizing the public offering channel, and enhancing transparency of pre-trade and post-trade information.

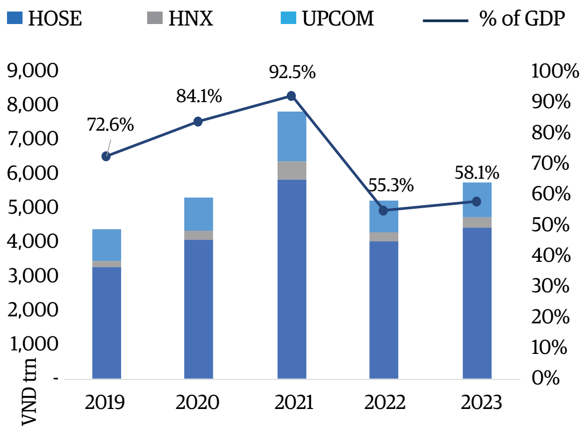
1.4. Equity market

Emerging Market status upgrade requires significant reforms to expand investor base and ensure market stability

Viet Nam's equity market has strong potential to be a major source of financing for the private sector. To underscore its potential, in the past decade, market capitalization grew from 38 to 58 percent of GDP, even hitting a peak of 93 percent in 2021 (Figure 2.12). This includes the two regulated exchanges– Ho Chi Minh Stock Exchange (HOSE) and Hanoi Stock Exchange (HNX)—with combined market capitalization of VND 4,740 trillion (US$198 billion), accompanied by an unlisted public company market (UPCOM) of about VND 1,036 trillion (US$43 billion). However, despite the large market capitalization, capital raising on the two main exchanges has been subdued and averaged VND 37 trillion (US$1.5 billion) annually over the last five years, primarily through secondary offerings rather than Initial Public Offerings (IPOs) (Figure 2.12).[25] IPO activities were most significant in 2017-18 but have declined significantly since then. In 2023, only three IPOs took place, raising VND 173 billion (US$7 million).

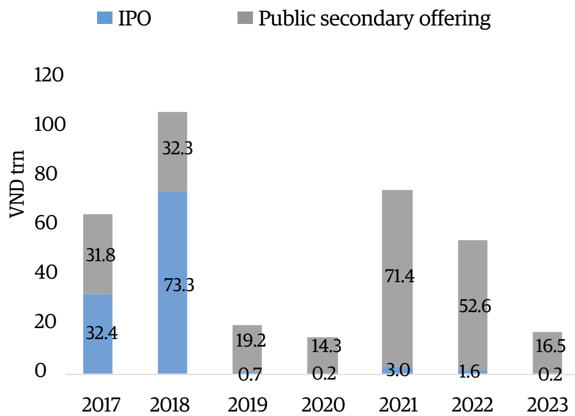
Viet Nam's stock market is the most volatile in the region, triggered by a combination of supply and demand factors. On the supply side, despite 1,632 companies currently with shares listed or registered for trading, the number of investible shares is relatively small. Not only is the average size of companies in Viet Nam's equity market smaller than in other countries regionally, the availability of shares is also adversely impacted by foreign ownership limits applied to certain sectors (as discussed below). This leads to high price volatility when investors wish to buy or sell stocks (see Figure 2.13). On the demand side, the market lacks investor diversity, as it is dominated by individual investors representing the vast majority (89 percent) of trades in the last five years. Individual investors tend to display herd behavior with shorter-term horizons. A wider investor base, especially an expanded presence of institutional investors, would help stabilize stock prices. As pension funds, insurance companies, and public investment funds all have different considerations when entering or exiting the market, a buy or sell action by one type of investor would have less impact on market prices. As equity market health is often seen as a key barometer of a national market economy, it is critical to maintain the long-term growth trajectory with reduced volatility.

Figure 2.12. Viet Nam stock market capitalization



Source: HNX, HOSE

Figure 2.13. Capital raising in equity exchanges (HOSE & HNX)



Source: FiinGroup, SSC

[25] Equity fundraising in the UPCOM market was estimated at VND 32 trillion (US$1.3 billion) per year on average in the past five years.

Going forward, as Viet Nam aspires to become a high-income country, it needs to attract significant international investment to drive its long-term growth. As the size of the domestic investor base remains small (as discussed in Section 2), the country requires additional support from international portfolio investors. Currently, Viet Nam is classified as a Frontier Market by MSCI and FTSE Russell—two of the world's largest index providers by amounts of funds following their indices. An upgrade or reclassification to Emerging Market status would represent a significant boost for Viet Nam's market to be recognized as investable in terms of access for foreign investors and equities of sufficient size and liquidity to be attractive. To achieve this upgrade, specific steps are required in the following key areas:

(i) **Pre-funding and pre-blocking of trades.** Before any trade, buyers must have the cash in place and sellers must hold the securities, which immobilizes cash and obstructs efficient trading by institutional investors who need to transfer cash to/from other countries or to seamlessly rebalance their portfolios. Removal of this pre-funding practice is critical to attracting large international investors.

(ii) **Foreign ownership limits (FOLs) and limited foreign headroom.** Viet Nam sets FOL on its companies for reasons of national sovereignty, security, and public interest. As many FOLs are set between 30 and 50 percent, a foreign investor may be unable to find securities to buy without paying a large premium. Bank shares are particularly affected due to a relatively low FOL (30 percent), while they represent a large portion of the main stock indices (VN30), thus likely investment targets for large investors. Increasing the FOL or providing alternatives to shares which have already hit the FOL, such as through non-voting depository receipts, would help resolve this constraint.

(iii) **Equal access to information.** To ensure a level playing field, foreign investors need access to market news and information at the same time as local investors. For the largest companies, this may mean mandatory English language requirements for disclosure and gradual implementation of International Financial Reporting Standards (IFRS).

2. Investors

Diversification of investments, enhanced investor protection, and regulatory reforms are crucial to market stability and development

Investors are the providers of funds, the lifeblood within capital markets, referred to as the "demand side". Products may be well designed, but if there are insufficient investors to buy them, capital markets will be anemic. Markets become healthier and more active if there are more types of investors who react differently to specific economic or market events.

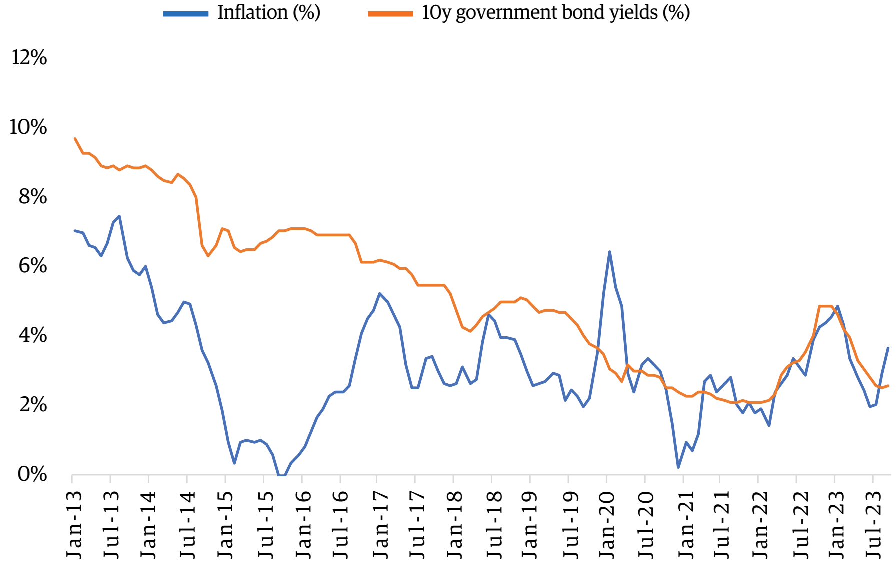
2.1. Public pension fund: the Viet Nam Social Security Fund

The fund (VSS) is the largest institutional investor in Viet Nam — currently managing a portfolio equivalent to 10 percent of GDP. Funds under VSS management are estimated at VND 1,130 trillion (US$44 billion) and expected to grow to 15 percent over the next few decades. VSS currently covers 32 percent of Viet Nam's working population (17.5 million employees), with a target of 60 percent by 2030.

As Viet Nam is one of the fastest-aging countries in the world, it is essential that VSS is financially viable in the long term so those contributing today can be confident they will receive adequate pensions in the future. Today's members are reliant on VSS to manage and grow their investments to become financially independent upon retirement.

Due to a legal constraint, VSS assets are heavily concentrated in government bonds. This adversely impacts its investment returns, distorts government bond yields, and hinders its contribution to broader capital markets development. The Law on Social Insurance permits VSS to only invest its funds in government securities or banks. As a result, government bonds make up 86 percent of VSS' assets under management (AUM), with the remainder bank deposits. VSS does not have investments in corporate securities. For VSS to be sustainable and deliver long-term financial security to retirees, it needs to generate sustained returns. The law effectively requires it to prevent the risk of losses. This ultra-cautious approach precludes making adequate returns to ensure its long-term sustainability and ability to pay benefits to its members. With VSS investments concentrated in government bonds, a safe destination, returns on this investment are diminishing as they reflect declining government bond yields in recent years. Today, the yields are already below inflation (Figure 2.14), leading to a loss of value in real terms. VSS' exclusive purchase of government bonds in auctions also contributes to discrepancies in the government bond market (as described in Section 1.2.). Additionally, the narrow scope of VSS investments means a missed opportunity to further develop financial markets with the addition of increased long-term investments.

Figure 2.14. 10-year government bond yields and inflation



Source: GSO, VBMA

Allowing VSS investment diversification would be a transformational reform. It would open the door to VSS investing in other higher-return opportunities and mean it would no longer need to accept any price offered in government bond auctions if too low. Internally, such a diversification if carefully and gradually implemented, would increase returns on VSS investments in the long run. Externally, this would not only reduce distortions in the government bond market, but it would also encourage growth in other markets it invests in, which are currently deprived of stable and large long-term investors.

2.2. Insurance companies

Insurance companies could play an impactful role in capital markets, in particular life insurance firms that must invest in long-term instruments to support matching long-term liabilities. By December 2023, the life insurance sector held VND 786 trillion (US$31 billion) in total assets, with a strong average annual growth rate of 20 percent in the last five years. Equivalent to 8 percent of GDP, it is the second largest type of domestic institutional investor in Viet Nam.

Despite its potential to help drive capital markets development, life insurance sector investments are heavily concentrated in government bonds and bank deposits. Combined holdings in these either low-yielding or short-term investments exceeded 80 percent (Table 2.2), meaning corporate securities holdings comprise less than one-fifth. Such an imbalanced portfolio may be driven by the challenges discussed earlier in relation to corporate securities markets (Sections 1.3 and 1.4). Insurers should be encouraged to diversify into the corporate sector, as concentrations in short-term investments and government bonds are inherently risky and limit returns. Addressing these problems in the corporate securities market will imbue more confidence in insurance companies to diversify which, in turn, will help the corporate securities market grow more healthily.

Table 2.2. Investment assets of life insurers, Dec 2022

Life Insurer Investments		
Asset classes	**VND bn**	**%**
Deposits	249,236	40.5
Government bonds	243,252	39.6
Unsecured corporate bonds, shares, and investment funds	73,226	4.4
Secured corporate bonds	26,891	11.9
Capital contributions	836	0.1
Real estate	67	0.0
Loans	12,881	2.1
Other	8,382	0.0
Total investment assets	**614,771**	**100**

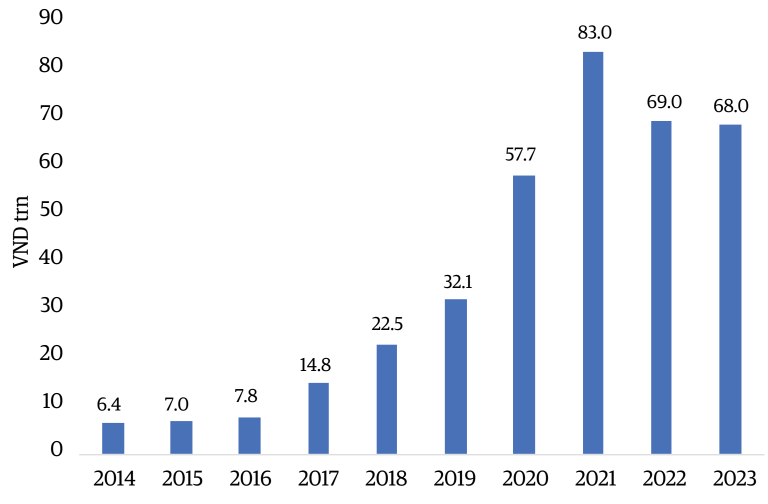
Source: Insurance Supervisory Authority

2.3. Investment funds

While Viet Nam's investment fund market is small, seeds of growth are evident. Since 2016, it has witnessed considerable growth of 36 percent annually, reaching a peak net asset value (NAV) of VND 83 billion (US$4 billion) in 2021. By the end of 2023, its NAV was VND 68 trillion (US$2.7 billion, Figure 2.15). There were 107 funds in operation, although two dominate: a fixed-income fund launched by a large domestic bank, and an exchange-traded fund that follows the main index (VFM VN30). Despite this progress, as of 2023, the fund industry accounted for just 0.7 percent of GDP, dwarfed by 29 and 34 percent in Thailand and Malaysia,[26] respectively.

With the right policy actions, the investment fund industry is in pole position to help finance the economy. Investment funds are great vehicles to mobilize individual and household savings as well as pool and channel them into professionally managed funds and good investments. This could give inexperienced investors indirect access to the private placement corporate bond market, for example. To realize this, investment funds should have more flexibility in their investments (e.g., allowing investment in unlisted assets exceeding the current regulatory limit of 10 percent of assets), while licensing and supervision should remain strict. Other changes to boost investment industry growth include the removal of double taxation of returns, enhancing distribution through banks and electronic channels with proper oversight, as well as enabling the creation of new types of funds, including umbrella (funds with 'sub-funds'), master/feeder, specific focus (green and sustainable), infrastructure, real estate, and foreign market funds.

Figure 2.15. Viet Nam investment fund's net asset value



Source: SSC

[26] Sources: Thailand's Securities and Exchange Commission, Securities Commission Malaysia.

2.4. Private pension funds

Despite their potential, voluntary private pension funds remain small. As a useful tool to diversify the pension system, they expand pension coverage and mobilize long-term savings. By the end of 2023, four licenses were issued for private pension fund managers with 10 funds operating. Total AUM has grown from VND 70 billion (US$3 million) in 2021 to VND 858 billion (US$34 million) in 2023. To jump-start growth, several steps must be taken, including relaxation of restrictive investment regulations, alignment of incentives with employee interests, expanding eligibility (automatic enrollment for employees by employers), and facilitating third-party contributions.

2.5. Domestic individual investors

Individual investors in Viet Nam have been significant contributors to capital markets, even during the COVID-19 pandemic. During 2020–21, the number of local investor accounts grew significantly, from 2.7 million in December 2020 to 4.3 million at the end of 2021. By the end of 2023, the total number hit 7.1 million, accounting for 7.5 percent of the population.[27] Active participation by individual investors is a positive market factor as they provide liquidity and a continuous price signal. However, if the market is highly dominated by individual investors, it tends to be volatile due to typically shorter investment horizons and herd behavior.

The definition of professional individual investors requires further calibration to avoid mischaracterization and ensure protection of retail investors. Individual investors can be grouped into two categories, retail and professional. Most individual investors are retail, meaning they are small-scale, unsophisticated, and therefore prone to abuse. However, the current legal definition of a professional investor and its application have made it possible for retail investors to be mis-categorized. For example, a legal requirement for a minimum-sized portfolio holding was circumvented by use of borrowed funds, which inflated investors' assets. Despite changes, they retain a low qualifying portfolio value and only came into force in 2024. Further reforms for authorities to consider include: (i) implementing a higher minimum value for single investments by professional investors, (ii) requiring securities firms to formally satisfy themselves that an investor has a good understanding of the risks and capacity to absorb losses and (iii) aligning the qualifying net portfolio value with those of other markets in the region.[28]

2.6. International investors

While such investors are scant in Viet Nam, with the right reforms they could enter in substantial numbers. At present, they are largely concentrated in the equity market and, even there, they hold less than 1 percent of all accounts and constitute only 8 percent of trading value.[29] While these are small percentages compared to other ASEAN-5 markets which have Emerging Market status or higher,

[27] Source: SSC.

[28] For example, US$300,000 in Thailand.

[29] Source: SSC

it should be noted that Viet Nam is still a Frontier Market. In ASEAN-5 markets, international investors typically represent 40 percent,[30] or more, of all trading value.

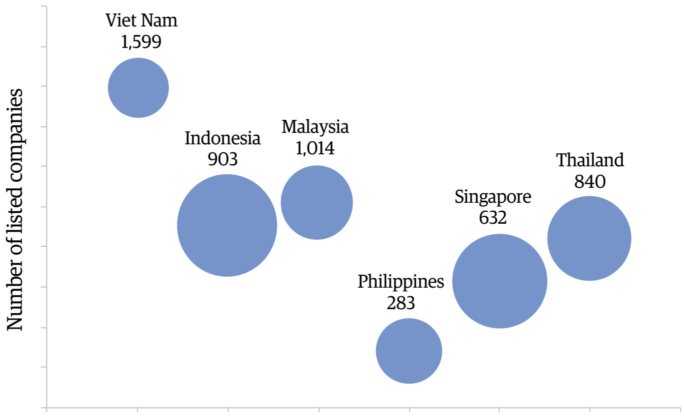
Significant specific improvements are necessary for Viet Nam's reclassification into Emerging Market status, while the overall environment and infrastructure must be robust. This means regulatory certainty, strong enforcement, credible price formation, and corporate transparency supported by efficient and reliable market infrastructure that encompasses trading, clearing and settlement as well as information infrastructure. Foreign investors are also impacted by administrative approvals required by authorities, which could benefit from streamlining.

3. Issuers

Enhancing governance and disclosure practices among issuers will strengthen market confidence and attract investment

As the prime users of capital markets to generate funding, issuers are on the "supply side" of the market. Aside from government, as the issuer of government bonds, Viet Nam has many actual and potential issuers in the non-government segments of capital markets. In Viet Nam's 2023 equity market, there were 743 listed companies on two stock exchanges, HOSE and HNX,[31] plus a further 856 on the UPCOM. These are large numbers relative to the economy's size and compared with other markets in the region (Figure 2.16).[32]

Figure 2.16. Number of listed companies relative to equity market size (2023)



Size of the circle represents the country's equity market capitalization

Source: FiinGroup, countries' equity exchanges

[30] The share of international investors per total trading value is 45 percent in Singapore, 38 percent in Thailand and 30 percent in Indonesia.

[31] These two stock exchanges are under the umbrella of the Viet Nam Exchange.

[32] The size of the circle in Figure 16 represents equity market capitalization in each country, while the numbers correspond with the number of listed companies on the exchanges. While Viet Nam has the smallest equity market capitalization compared to peer countries, it has the highest number of listed companies. This means the size of each listed company, on average, is much smaller and has great potential to grow.

The quality of issuers—in terms of governance and disclosures—is more important for market development than their sheer number. Having numerous low-quality issuers is counterproductive to market development as they heighten risks of manipulation, price distortions, abuse, and loss of confidence. Low quality transparency and disclosure also diminishes a market in the eyes of investors, who will apply a high 'discount' or undervaluation of a company's securities. Conversely, good governance and disclosure discipline attracts more investors at a lower capital cost.

A multi-pronged approach could enhance the quality of issuer information across Viet Nam's markets. These measures include establishing investor relations functions at issuers, promoting a practice of dual language disclosures (English and Vietnamese), and aligning Vietnamese Accounting Standards with the IFRS. A further way to address potential risks posed by weaker governance and disclosure practices is to provide clear differentiation of company categories and regulate how investors can access them. As the equity market in Viet Nam is comprised of three markets (HOSE, HNX, and UPCOM) with different rules, there are no major differentiations in terms of access for investors. Given that UPCOM is not a listed market, access should be limited. Authorities are also encouraged to make it easier for companies to delist and not focus resources on companies with no true public investors nor interest in raising funds from the public. That said, policies should facilitate access for all types of enterprises to create a well-diversified capital market. While issuers in the equity market must be public companies, non-public firms should remain able to access the corporate bond market, whether through public offers or private placements.

4. Intermediaries

Oversight and coordination among intermediaries must be improved

Intermediaries are important actors ensuring the flow of savings into investments and implementation of good market practices. Securities firms are specialized capital market intermediaries, licensed by the State Securities Commission (SSC) to conduct a range of activities, including investment advice, brokerage, dealing, custody, and underwriting functions. As the SSC cannot effectively supervise all investors and issuers directly, securities firms are the first line of defense to ensure adherence to regulations as they serve both investors and issuers. In recent years, authorities have paid significant attention to governance, systems, and financial conditions, while weeding out weaker firms. By the end of 2023, some 82 securities companies were licensed in Viet Nam.

As a positive driver for market development, some commercial banks also act as capital market intermediaries. These banks conduct securities intermediation activities mostly through subsidiaries dedicated to securities businesses. While banks' participation has a positive impact on market development due to expanded client bases and resources than securities companies alone, it must be carefully regulated and supervised to avoid regulatory arbitrage and the potential mis-selling of securities market products to bank customers who may not be fully informed of risks. Bank employees should receive specific training and possibly licensing before they can sell securities products. Given the interactions between banks and the securities sector, close coordination between the SSC (as supervisor of securities markets) and the SBV (as supervisor of banks) is important.

5. Infrastructure

Market infrastructure requires upgrading, with enhanced role of credit rating systems

Numerous entities in Viet Nam provide infrastructural support for the execution, clearing, settlement and recording of transactions — all supervised by the SSC. Trading is carried out on the HNX and HOSE, now being brought into one corporate structure under the Viet Nam Stock Exchange (VNX). The sole central securities depositary, the Viet Nam Securities Depository and Clearing Corporation (VSDC), covers government bonds, corporate bonds and equities, with the responsibility for clearing and settlement of trades. The SBV operates the payments system and acts as the settlement bank for government bond trades, while trades in corporate securities are settled through a state-owned commercial bank.

It is critical that market infrastructure keeps pace with a growing market. Already, the mix of manual and electronic processing in the government bond market settlement process constrains efficiency. Moreover, it prevents same-day settlement of government bonds, limiting liquidity management operations. In the equity market, a central counterparty arrangement is under development to mitigate settlement risks. As a future upgrade to Emerging Market status would bring more international investors into Viet Nam, the process of entering and exiting the market should be as efficient as possible.

Credit rating agencies are integral to the investment process as they provide credit information about issuers to potential investors. Hence, they are part of the information infrastructure for the market. There are three currently in Viet Nam, two of which cooperate with international agencies, with some expressing an interest in establishing a local presence. However, as ratings are not obligatory for most bonds, there was no rated bond in the market at the time of this report.

6. Institutions

Strengthening risk-based supervision and enforcement is critical for safeguarding market integrity

As regulatory and supervisory institutions guide market development, supervision needs to become increasingly risk-based and well-coordinated as markets become more complex. While compliance with rules is important, a supervisor's resources should be focused on what really matters to its objectives and where risks are likely to occur. This means risk-based supervision and prudential oversight require an increased SSC mandate and capacity. The interlinkages between capital markets and other parts of the financial system are significant and growing, which means that contagion and systemic risks are also heightened. This places the onus on authorities to draw up a coordinated and effective response encompassing, for example, banking policies and regulations that affect capital markets (as issuers, investors, intermediaries, and infrastructure).

Enforcement against market misconduct and non-compliance must be strong and visible, with penalties delivering a strong deterrent effect. Until recently, penalties for non-compliance lacked teeth to change behavior in any significant way. For example, the maximum fine for non-compliance with information disclosure requirements was VND 100 million (US$4,350). Yet, recently uncovered fraud in corporate bonds linked to the real estate sector and commercial banks eventually resulted in criminal charges with severe punishments. A spectrum of penalties with strong deterrent effects, before criminal charges are applied, could be considered. To align Viet Nam's regulatory and supervisory practices with international standards, a fresh assessment of implementation of the Objectives and Principles of Securities Regulations, issued by IOSCO, should be considered.[33]

III. Core challenges and looking ahead

If Viet Nam is to unlock the potential of its capital markets, several specific hurdles need to be overcome to ensure healthy and sustainable growth. A fundamental issue in Viet Nam is the underdevelopment of the institutional investor base, including the underutilization of VSS, a potentially dominant force in driving capital market development. While it is larger than all other institutional investors combined, it is effectively mandated to only invest in government bonds, aside from depositing funds in banks. The absence of a large weight of institutional investors in non-government bond markets also allows individual investors to dominate, which can create volatility from herd behavior. This also contributes to the accumulation of risks within the corporate bond market and stunts the development of the equity market to play its financing role for the corporate sector.

Concentration and dominance of VSS in the government bond market

The almost exclusive placement of the VSS portfolio in government bonds not only limits investment returns, but it also creates distortions in financial markets and adversely impacts financial sector development. Figure 2.14 already shows declining government bond yields, perhaps a good near-term factor for the government as borrowing costs are low, but it also means declining returns on VSS investments. Meanwhile, market inefficiencies caused by VSS investments include artificially low government bond yields at auction, irrelevance of government bond yields as price references for other financial instruments, and the narrow focus on long-tenor government bond issuances that potentially put the balance sheets of commercial banks at risk. Commercial banks requiring extra liquidity for safe instruments have little choice but to purchase these bonds, increasing the risk of maturity mismatches given their short-term source of funding (deposits). The low yields and longer average maturities of government bonds may be good for the government in the short run, but they may depress returns to VSS assets and impede the growth of reserves needed to pay future pension liabilities.

VSS investment diversification would accelerate the modernization of Viet Nam's financial system from several distinct angles. Firstly, it would remove it from a captive status in the government bond market, thus reducing market distortions. Secondly, diversification into corporate securities markets

[33] The latest assessment of IOSCO Principles implementation in Viet Nam was conducted in 2013.

– stocks and bonds – would support development of these markets through investor diversity and provide relative market stability as a long-term investor. Even if VSS did not invest directly into these markets from the outset and instead entered through niche funds, its entrance would trigger more competition and professionalism in the asset management industry. Finally, if properly implemented on a small and gradual basis, such diversification would increase returns on VSS investments in the long run.

Absence of institutional investors in the corporate sector

Along with the VSS, other institutional investors should add their weight to drive corporate sector development. Outside of VSS, only life insurers are relatively sizeable, but they are concentrated in government bonds and bank deposits. This means corporate securities markets are dominated by non-professional investors prone to herd behavior and vulnerable to mis-selling and abuse. This also means higher quality issuers across all economic sectors are not encouraged to come to market. In developed markets, pension funds and institutional investors are key purchasers of corporate equities, bonds, money market funds and niche investment funds, as well as drivers of development in other instruments. To reverse this, action is needed in parallel with VSS diversification: life insurers need to diversify into the corporate sector, investment funds and private pension funds should be promoted, allowing them to offer more niche services to individual investors.

Modernizing corporate bond and equity markets as financing and investment instruments

To catch the eyes of institutional investors, the corporate bond market requires a makeover — especially in transparency and investor protection. This is necessary to rebalance from individual to institutional investors. The market entry of professionally licensed investment funds and other institutional investors must be facilitated in line with similar markets in other jurisdictions, as these institutional investors are better equipped than individuals to assess, price, and absorb associated risks. Investment funds should be encouraged to flourish as the natural channel into this market for retail and other investors. The definition of professional investors should be refined to better reflect investors who can appreciate risks, while processes for public offer bond issuances should be streamlined. Further, credit ratings should be more widely required, especially where instruments are offered to individual investors.

The equity market has a striking potential to develop into an important source of corporate sector financing. Market capitalization headline statistics are impressive, but amounts raised are less remarkable. Compelling international investor interest in Viet Nam's equity market is on hold, waiting for structural adjustments to be implemented and proven. The authorities are making significant efforts to address the three critical areas—prefunding, foreign headroom due to FOL, and equal access to information—to meet these expectations. Continuous dialogues with the international investor community is critical in this process. Domestically, the stock exchanges and authorities will also need to consider how to better incentivize corporates to raise funds through the markets, rather than simply to list, so that international and institutional investors begin to look for opportunities to invest in corporate securities. A true test of success of an equity market's development is not increases in stock prices, but the amounts raised by the corporate sector.

Towards modern capital markets to unlock growth for Viet Nam

Properly integrated, Viet Nam's capital markets can be an effective tool for financing, savings, and pricing signals needed for efficient allocation of economic resources. Capital markets can amplify the transmission of monetary policy designed to set future pricing signals for financial assets. Credible short-term reference rates, for instance, would boost growth of the interest rate swap market to provide banks and other financial institutions with important risk management tools. A government bond yield curve based on a liquid secondary market without significant distortions would provide credible price references for other financial instruments, including those with medium- and long-term tenors, to help develop the market for long-term financing to complement that from the banking sector. An efficient equity market would also provide strong signals for asset prices and investment opportunities across different sectors, thus supporting efficient allocation of capital.

Proper reforms, if carefully implemented, will help to unlock significant additional long-term capital for Viet Nam's corporate sector. A modest allocation of VSS investment into corporate securities could mean an additional US$20 billion for the corporate sector by 2030.[34] Extra returns may also accumulate US$4 billion by 2030. Similarly, reallocation of a modest portion of life insurance investment into corporate securities could mobilize US$15 billion within the same timeframe.[35] Healthy growth in investment funds and private pension funds could bring around US$14 billion.[36] Meanwhile, an upgrade into an Emerging Market status by MSCI and FTSE Russel could mean a net inflow of US$5 billion into the Viet Nam's equity market, as a result of portfolio reallocation of global Emerging Market into Viet Nam following the upgrade. Inflows could reach US$25 billion by 2023 if strong reforms continue and the global investment environment remains healthy.[37] Overall, this means an estimated US$78 billion in funding for the corporate sector by the end of the decade through capital markets alone.

Healthy growth in capital markets would also bring positive externalities to the overall economy, through efficient allocation of capital. Viet Nam will be able to achieve a higher economic growth, not only because domestic resources are used more productively, but also because it is leveraged with much-needed capital from the international market to achieve its ambitious high-income goal. Therefore, a concerted effort to develop the capital markets should be a key objective of the government and all stakeholders.

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[34] Assuming a gradual diversification into corporate securities of up to 25 percent, with VSS investable assets growing consistently with past growth trends, reaching an aggregate AUM of US$80 billion in 2030.

[35] Assuming a reallocation of one-fifth of life insurance investment into corporate securities.

[36] Assuming that the investment fund industry reaches 6 percent to GDP and the private pension funds cover an additional 1 percent of total workers.

[37] Continued reforms, such as addressing the FOL issues and successful equitization or IPOs of large companies, will likely increase Viet Nam's weight in the EM indices, leading to further reallocation of global investors' portfolio into Viet Nam. Furthermore, a healthy global investment environment would ensure a persistent growth in the assets under management of global investors investing in emerging markets. The pool of assets benchmarked to MSCI equity indices, for example, was estimated to have grown at more than 7 percent per year during 2014-2021.

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