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Vietnam's economy

The Tet effect

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Worries about renewed overheating



DURING Tet, the lunar new year holiday, money is everywhere in Vietnam. It is dished out to children, gambled in roadside card-games, and splurged on gifts, feasts, and trips to home villages. This leads to an annual bump in inflation. And this year's spike in the consumer-price index, which rose by 2% in February, seemed bearable at a time of rapid growth. GDP grew by 5.3% last year. It came, however, among some more worrying signs.

On February 10th, just before Tet, the central bank devalued the currency, the dong, by 3.4%, following a devaluation of 5.4% in November. The aim was to entice holders of dollars to buy dong. A dollar shortage has been starving Vietnam's exporters of the currency they need to purchase imported parts and materials.

The government blamed the shortage on dollar hoarding, but the prime cause was its own stimulus spending. That juicy growth-rate came at a price. It is believed to have spent over \$1 billion in 2009 (over 1% of GDP) to prop up the economy, mainly by subsidising banks' loans to businesses. As a result, the credit supply expanded by 37%, driving up the black-market price of dollars.

Meanwhile, the exchange rate was artificially high, leading to a sharp rise in the trade deficit. Foreign-exchange reserves have shrunk. The government has reluctantly raised state-controlled commodity prices: petrol, electricity and coal are all to be more expensive. All of this has observers wondering whether inflation might be about to take off again, as it did in early 2008.

Some analysts saw it coming. In April last year Jonathan Pincus, an economist who has long followed Vietnam, wrote a paper arguing that Vietnam's options for responding to the global financial crisis were limited. With a small, open economy, it cannot maintain an overvalued exchange rate and pour in stimulus spending without

seeing much of the money leak away into trade deficits. At the time Mr Pincus argued it should depreciate its currency to boost exports, and focus investment on labour-intensive small businesses rather than inefficient state-owned enterprises (SOEs). The government did the opposite. The loan-subsidy programme largely benefited well-connected SOEs, and the currency has been kept artificially strong.

Independent Vietnamese economists have criticised the timing of the government's devaluations and price rises. If investors expect devaluations every three months, they argue, they will buy dollars and wait for the next one. Foreign businesses, meanwhile, are worried about how the government might respond if inflation does take off. The finance ministry has been circulating a draft decree that would allow the government to impose price controls on a wide range of essential goods. The European Chamber of Commerce has warned that such measures may well lead to nothing but "shortages" and "hoarding". So March's inflation data will be closely watched, for evidence of whether February's were simply a seasonally exuberant blip, or something more dangerous.

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