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Economic growth and macroeconomic stability of Vietnam in the 2001 - 2023 period

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Abstract

This article shows the development of Vietnam's economic growth in the period 2001-2023 and the relationship between economic growth and variables measuring macroeconomic stability, including the inflation rate - an important indicator in evaluating the level of macroeconomic stability and the trade balance and budget balance - two other major indicators in the economy. Studies using econometric models for data sets of many countries have shown an inverse relationship between the inflation rate and economic growth or that if the inflation rate exceeds a certain threshold, inflation will adversely affect economic growth. Using the descriptive statistics method for Vietnam's data for the period 2001-2023 also shows this inverse relationship. Besides, the statistical relationship between economic growth with the trade balance and budget balance leads to the conclusion that maintaining macroeconomic stability, controlling inflation, and ensuring major balances of the economy as a current priority of the Government is an essential condition in promoting economic growth and contributing to helping the economy overcome difficulties and adverse shocks.

Keywords: Inflation, trade balance, budget balance.

JEL classification: E31, E63, F43, H62.

Since 2001, Vietnam's economy has experienced more than two decades of fluctuations with many memorable milestones. Economic growth from a low level at the beginning of the research period gradually increased until the years before Vietnam joined the World Trade Organization. After that, external shocks combined with internal economic weaknesses increased instability and economic growth declined. Macroeconomic stability is an essential condition for growth. Looking at the more than 20 years that the economy has just gone through to see more clearly the relationship between growth and stability, thereby suggesting policy lessons for the future when the goal for the next period is rapid and sustainable growth in the context of weakening growth momentum of both the global and domestic economies due to regional conflicts and internal weaknesses.

The article is structured as follows: following the introduction, part 1 will present the economic growth of Vietnam in the period 2001-2023; part 2 will depict the picture of macroeconomic stability through the critical index of inflation rate; part 3 will analyze the relationship between the two variables of economic growth and macroeconomic stability, focusing on the relationship between economic growth and inflation; and finally, part 4 will give some assessments and policy suggestions for the next period.

1. Economic growth in the period 2001-2023

During 2001-2023, Vietnam's economic growth, measured by GDP growth rate, experienced many fluctuations. Economic growth was at a low level of 6.2 percent in 2001, then increased to its peak during the years 2004-2007 (above 7 percent) before Vietnam joined the World Trade Organization and encountered a double shock: the global financial crisis and record-high world oil prices in 2008.

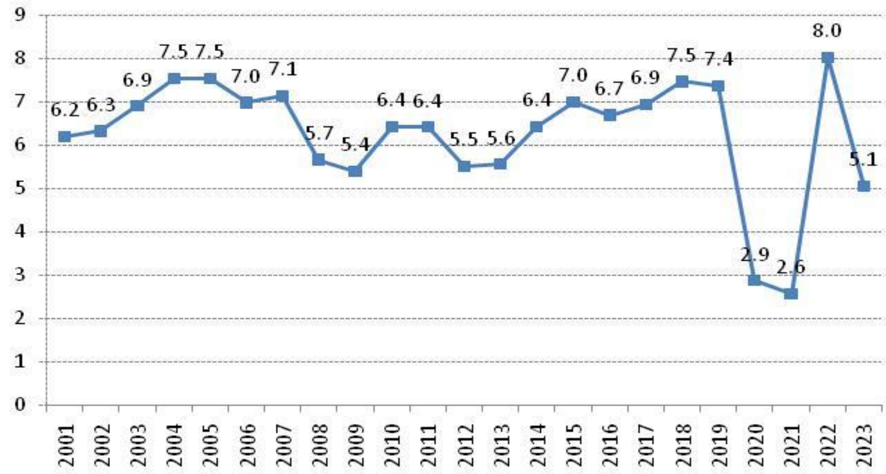
Under the impact of the double shock on the economy, economic growth declined to 5.7 percent in 2008 and 5.4 percent in 2009. In 2009, the Government issued an economic stimulus package divided into three groups (Pham Sy An, 2009): policies aimed at households and stimulating consumption; policies aimed at businesses and construction investment; and monetary and exchange rate policies. These policy groups were implemented at the end of 2008 and the beginning of 2009, immediately after the financial crisis hit the economy.

The 2009 stimulus package boosted growth in 2010 but also left side effects of increased inflation and asset price bubbles in 2011. In response, the State Bank of Vietnam implemented tight monetary policies, causing interest rates to rise (both deposit and lending rates) and leading to the collapse of many private enterprises (the number of bankrupt, dissolved, and temporarily suspended enterprises exceeded the number of newly registered enterprises).

The fluctuation in growth rates closely reflected the Government's policy responses: growth increased in 2010 (6.4 percent) and 2011 (6.2 percent) when the Government's economic stimulus policies were implemented, but then sharply decreased to 5.2 percent in 2012 when the side effects of the stimulus policies took effect.

At a time when economic growth was at its lowest, the Government decided to restructure the economy. In 2013, the Prime Minister issued Decision No. 339/QĐ-TTg on February 19, 2013, approving the overall project to restructure the economy associated with transforming the growth model towards improving quality, efficiency, and competitiveness during 2013-2020. Since the decline in 2012, economic growth tended to increase until 2019. However, the outbreak of the COVID-19 pandemic in 2020, along with the policy responses both globally and domestically, severely affected economic growth. The global supply chain was disrupted, and many business activities had to be temporarily halted due to quarantine measures. Figure 1 shows the most significant impact of the COVID-19 shock on the economy (in terms of output growth). Economic growth fell sharply from 7.36 percent in 2019 to 2.87 percent in 2020 and 2.56 percent in 2021 before rebounding to 8 percent in 2022, but then decreased to 5 percent in 2023.

FIGURE 1: **Economic growth rate in the period 2001-2023, percentage**



Source: General Statistics Office.

2. Macroeconomic stability in the period 2001-2023

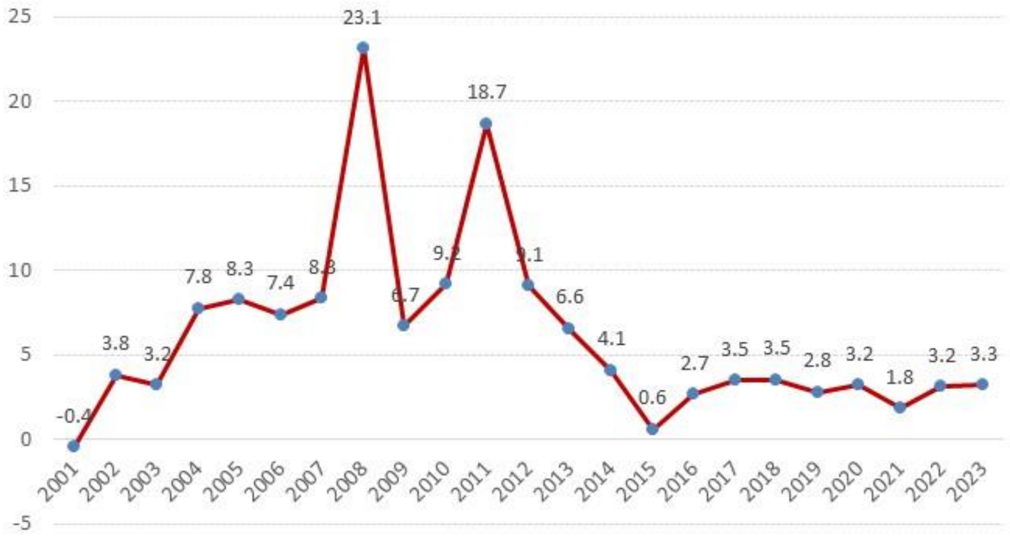
Macroeconomic stability in 2001-2023 is reflected in the critical index of the inflation rate, as shown in Figure 2. In the first three years of the research period, the inflation rate was low, below 4 percent, and even negative (-0.4 percent) in 2001, meaning prices decreased. This period was influenced by the Asian financial crisis in 1997, resulting in weakened aggregate demand and low global fuel prices, leading to low expected inflation.

The inflation rate was higher in the subsequent four years (2004-2007), averaging around 7.9 percent. High inflation was partly due to the impact of the Government's economic stimulus package in 1999. However, the inflation rate skyrocketed in 2008, reaching a peak of 23 percent, the highest between 2001 and 2018. Global oil prices hit a record high at this time, combined with ill-advised monetary policies in response to an influx of foreign capital when Vietnam joined the World Trade Organization. Due to the global financial crisis in 2008, world oil prices dropped, and the economy's aggregate demand weakened in 2009-2010, causing the inflation rate to plummet sharply (as well as the sharp increase) to 7 percent in 2009 and 9 percent in 2010. In 2009, the Government implemented an economic stimulus package, as detailed above, which positively impacted economic growth and caused the inflation rate to rise significantly (19 percent in 2011). This inflation phenomenon during this period is known as "recurrent inflation", meaning inflation rises, falls, and then rises again.

Since the high inflation rate in 2011, the Government has implemented measures to prioritize macroeconomic stability over economic growth as in the previous period. Government Resolution No. 11/NQ-CP, issued on February 24, 2011, focused on major solutions to curb inflation, stabilize the macroeconomy, and ensure social security. This marked a significant policy shift from prioritizing economic growth to concentrating on macroeconomic stability. The two leading policy solutions were related to monetary policy and fiscal policy. Accordingly, tight and cautious monetary policy was implemented, harmonizing monetary and fiscal policies to curb inflation; controlling and ensuring credit growth in 2011 below 20 percent and monetary aggregate around 15-16 percent; prioritizing credit for agricultural production, rural areas, exports, supporting industries, small and medium-sized enterprises; reducing the rate and proportion of credit to non-productive sectors, especially real estate and securities. Fiscal policy was tightened by cutting public investment and reducing the state budget deficit.

The policy solutions focused on macroeconomic stability, along with a sharp drop in global oil prices, resulted in a significant decrease in the inflation rate over the next four years (down to 9 percent in 2012, 6.6 percent in 2013, 4 percent in 2014, and 0.6 percent in 2015) and maintained at below 4 percent in the following years. The priority in policies, especially fiscal and monetary policy, has always been ensuring macroeconomic stability and controlling inflation. For instance, on January 5, 2024, at the National Online Conference summarizing the work of 2023 and implementing tasks for 2024, among the main tasks and solutions, "promoting growth, maintaining macroeconomic stability, controlling inflation, ensuring major balances of the economy" was given top priority. In fact, ensuring macroeconomic stability and effectively controlling inflation has helped the economy overcome the toughest challenges recently.

FIGURE 2: **Inflation rate in the period 2001-2023, percentage**



Source: World Bank.

3. Relationship between economic growth and macroeconomic stability

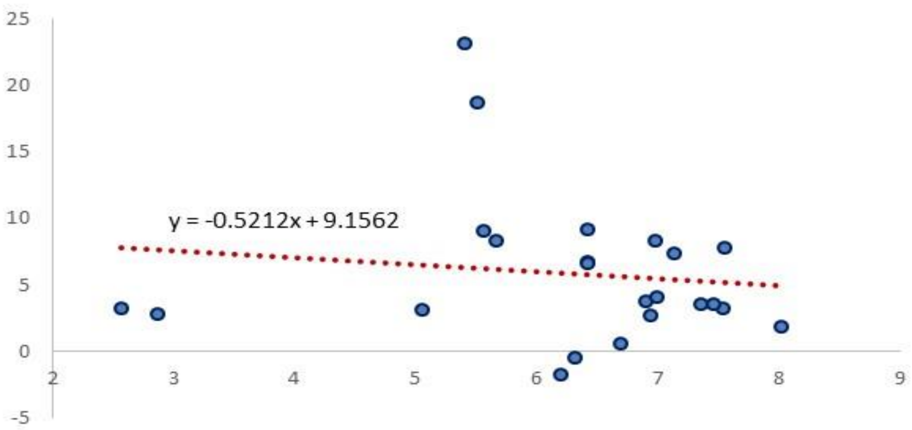
Examining the relationship between the two most important variables of the economy, economic growth and inflation rate, reveals a clear inverse relationship. When the inflation rate was high in 2008, economic growth immediately fell to its lowest level in 2009 (5.4 percent). Similarly, in 2011, when the inflation rate was high at 19 percent, economic growth dropped to its lowest point (5.2 percent) in 2012. Macroeconomic instability, reflected by high inflation rates, negatively affects economic growth.

Figure 3 shows the relationship between macroeconomic instability and economic growth. The correlation coefficient between these two variables is -0.12, which means that years with high inflation rates often coincide with years of low economic growth and vice versa; years with low inflation rates often coincide with years of high economic growth. Correlation does not imply causation. However, many international studies show that low and stable inflation is essential to high economic growth.

Conversely, an economy with high and volatile inflation rates will always be accompanied by low economic growth. For example, Ekinci et al. (2020) pointed out that an exceeding a 4.182 percent inflation rate threshold could negatively affect economic growth. Fisher (1993) also pointed out that high inflation negatively impacts economic growth by reducing productivity and investment.

So why is there an inverse relationship between inflation rate and economic growth? On the one hand, low inflation rates create stability in the macroeconomy, interest rates, and exchange rates, thus encouraging long-term investment by businesses. On the other hand, low inflation rates reflect (and result from) the government's operational capacity, which contributes to promoting economic growth. Perhaps in many cases where it is not possible to separate the causes clearly, high inflation rates will create macroeconomic instability and simultaneously reflect the government's operational and policy coordination capacity, thereby reducing economic growth through various mechanisms.

FIGURE 3: **Economic growth and inflation rate in the period 2001-2023**



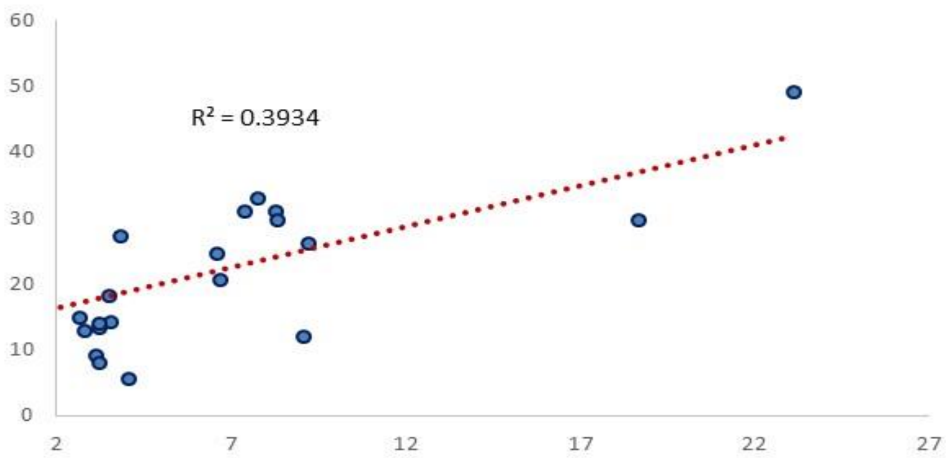
Note: The economic growth rate and inflation rate are in percentage (%).
The inflation rate is taken from the previous year because the previous year's inflation rate affects the current year's growth.
Source: General Statistics Office.

The relationship between the inflation rate - an essential aspect of macroeconomic stability and economic growth and the factors behind it are significant, so we will examine this relationship and the factors behind it more closely.

High inflation negatively impacts economic growth. Theoretically, money supply or cost shocks - demand-side and supply-side factors - are critical to inflation. In the aggregate supply-demand model, an increase in money supply shifts the aggregate demand curve, increasing output and raising inflation. However, if the money supply continuously increases, economic growth may not rise, and only inflation will increase (Friedman, 1968). A continuous increase in money supply will lead to inflation expectations, setting higher wages and production costs, thus raising prices (from the supply side). Behind the process of increasing the money supply are many reasons, such as injecting money through the banking system to support growth, covering budget deficits, and financing public projects.

According to Friedman (1968), the money supply often impacts growth after about 6-9 months but affects inflation after 12 months. Figure 4 shows the relationship between money supply (M2 growth rate) and inflation rate (CPI growth rate), calculated with a one-year lag. The correlation coefficient between these two variables is 0.62, which implies that a high inflation rate often follows a high increase in money supply, and vice versa; a low rise in money supply is often followed by a low inflation rate. The word “often” implies that a high money supply does not increase yearly, leading to a high inflation rate afterward.

FIGURE 4: **Relationship between money supply and inflation rate in the period 2001-2023, percentage**

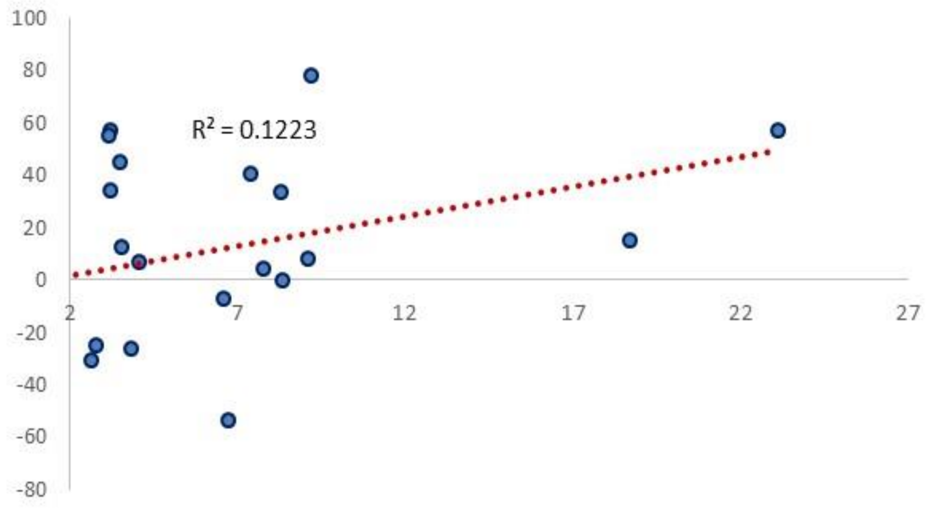


Note: Inflation rate is taken with a one-year lag.

Source: World Bank.

The cause of inflation is not only due to money supply (demand-pull inflation) but also other factors, such as rising crude oil prices (cost-push inflation). Increasing world oil prices can negatively impact the inflation rate and economic growth. Figure 5 shows the relationship between crude oil prices and inflation (with a one-year lag). The correlation coefficient between these two variables is 0.35. Although correlation does not imply causation, it can be affirmed that an increase in world oil prices will increase the inflation rate because world oil prices can affect our country's inflation. At the same time, the reverse cannot happen: Vietnam's inflation does not affect world oil prices. The sharp increase in world oil prices in 2007 and the peak in 2008 contributed to our country's high inflation rates in 2007 and 2008.

FIGURE 5: **Relationship between crude oil prices and inflation**



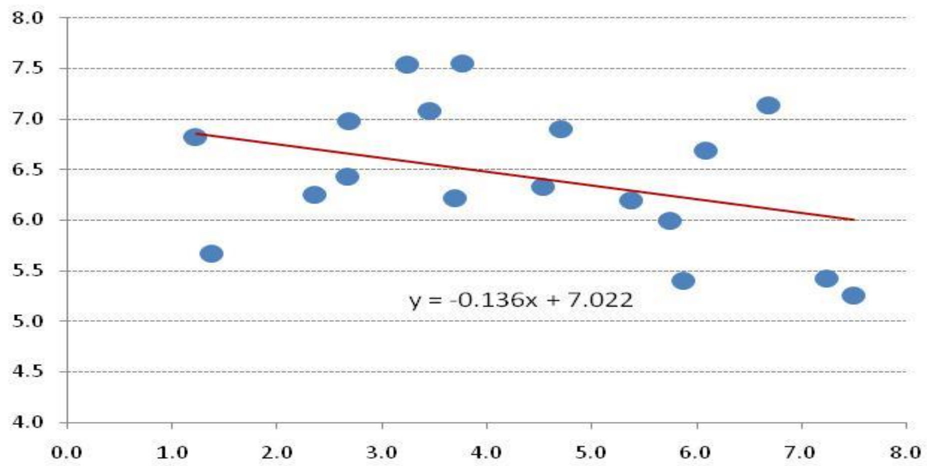
Source: World Bank.

The relationship between Vietnam's inflation rate and economic growth from 2001 to 2023 reflects the most important aspect of stability and economic growth. Below, the relationship between stability and economic growth will be analyzed more closely through the relationship between economic growth and budget deficits and trade balances-two other important variables reflecting macroeconomic stability.

Figure 6 shows the relationship between budget deficits - measured as a percentage of the current GDP - and economic growth. For convenience, the budget balance in 2001-2018 was always in a deficit (negative), but we have converted it to a positive sign to make the analysis easier. The correlation coefficient between economic growth and budget deficits is -0.4.

In other words, these two variables move in opposite directions. Large budget deficits are often accompanied by low economic growth, and vice versa; low budget deficits are often accompanied by higher economic growth. Some studies (e.g., To Trung Thanh, 2011) show that public investment crowds out private investment, meaning that increasing government spending - in the investment component - will crowd out private investment. Public investment not only directly competes for resources with private investment but also often comes with inefficiencies and waste, so increasing public investment will result in lower economic growth instead of higher growth. Public investment is not necessarily bad or has negative impacts if such investment focuses on improving infrastructure, thereby attracting and leveraging more private investment.

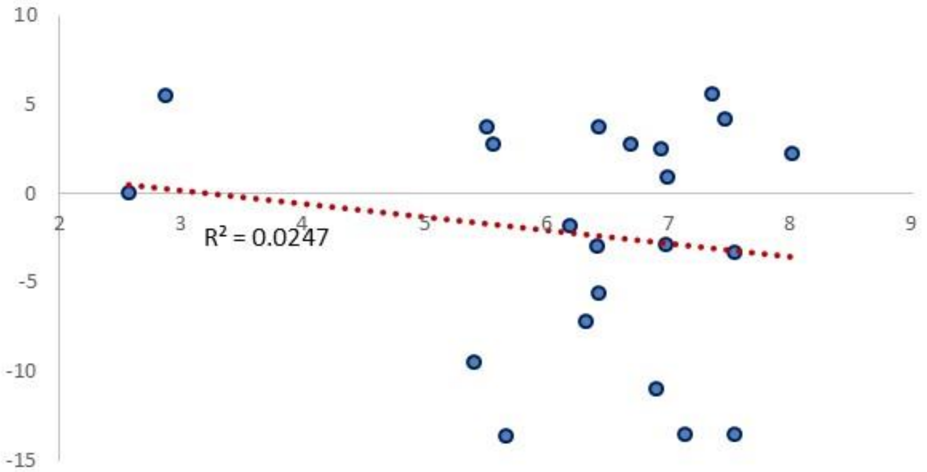
FIGURE 6: **Budget deficit/GDP and economic growth, percentage**



Source: General Statistics Office.

Figure 7 shows the relationship between economic growth and Vietnam's trade balance in 2001-2022. The correlation coefficient between these two variables is -0.16, which means that years of high economic growth often have more extensive trade deficits, and vice versa; years of low economic growth often have smaller trade deficits or even surpluses. This correlation does not imply that creating a trade deficit will promote economic growth. Unlike inflation or budget deficits, which are often factors causing economic growth, the trade balance usually reflects the outcome of economic growth. Years of high economic growth lead to high import demand for production inputs, resulting in larger trade deficits. High economic growth also increases people's income, raising demand for imported goods (wealth effect).

FIGURE 7: **Trade deficit/GDP and economic growth, percentage**



Source: World Bank.

4. Conclusions and policy recommendations

Vietnam's economy has undergone many ups and downs over more than 20 years (2001-2023). At the beginning of the research period, due to the impact of the Asian financial crisis in 1997, economic growth declined. However, the 1999 stimulus package and the recovery of Asian economies led to a gradual increase in Vietnam's economic growth from 2001, reaching its peak in 2004 (7.8 percent). The economic growth continued high before Vietnam joined the World Trade Organization. However, in 2008, the global financial crisis and economic recession had a strong negative impact on Vietnam's economy. The combination of the financial crisis, economic recession, high oil prices, and the increase in prices of many production input materials resulted in both declining economic growth and macroeconomic instability.

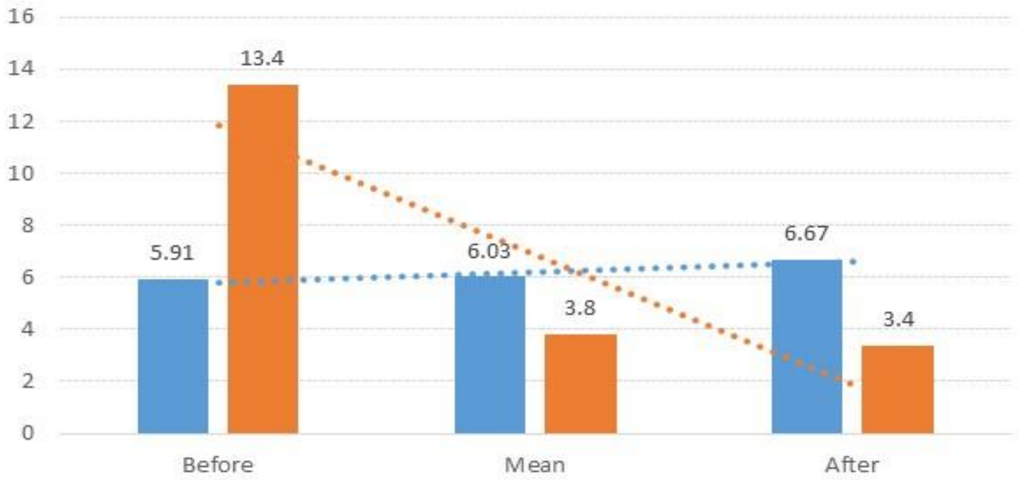
Although the Government implemented the 2009 economic stimulus package, which boosted economic growth in 2010-2011, its side effects, such as high inflation, asset price bubbles, and increasing bad debts in the banking system, had a strong negative impact on economic output.

Besides external shocks, internal structural problems accumulated over time, exacerbating the decline in economic growth and making recovery more complex.

At the beginning of 2011, the Government decided to restructure the economy and renew the growth pattern to improve productivity, competitiveness, and the business environment. Economic restructuring focused on three main areas: public investment, state-owned enterprise, and the commercial bank sector. Along with these three focus areas, sectors and enterprises developed strategies and plans to restructure their industries, sectors, or organizations accordingly.

The results were impressive. Economic growth has tendered to increase since the lowest point in 2012 (5.25 percent) and exceeded 7 percent for three consecutive years (2018: 7.47 percent and 2019: 7.36 percent). Figure 8 clearly shows high growth rates accompanied by low inflation rates.

FIGURE 8: **Economic growth and inflation before and after restructuring**



Note: Pre-restructuring: 2008-2012. Restructuring process: 2013-2015.
Post-restructuring: 2016-2018.
Source: General Statistics Office.

The history of Vietnam's economy during 2001-2023 shows that to achieve high economic growth, a stable macroeconomic foundation is needed: minimizing budget deficits and maintaining low inflation rates. It is necessary to strictly implement the hard budget constraint principle (similar to applying market rules to private enterprises), save, improve budget efficiency, and maintain low and stable inflation rates to reduce budget deficits. Monetary policy, specifically money supply growth, needs to be controlled to maintain low inflation rates. In recent years, monetary and fiscal policies have been managed to ensure macroeconomic stability, control inflation, and support economic growth. However, the unprecedented shock of the COVID-19 pandemic in 2020, combined with global supply chain disruptions, has led to a decline in economic growth in recent years.

Macroeconomic stability is only a necessary condition for rapid and sustainable economic growth. The sufficient condition for promoting rapid and sustainable economic growth requires open and free trade policies to create competitive pressure on Vietnamese enterprises while attracting foreign direct investment, enhancing the competitiveness of domestic enterprises to absorb technology and skills from foreign enterprises, and increasing investment in research, development, and innovation.

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