Update on the latest developments of the world economy and impact on Vietnam in 2022 and beyond

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The coronavirus pandemic is first and foremost a health crisis that has caused tremendous suffering and loss of life. It is also the most serious economic challenge in a generation, even greater in magnitude than the Global Financial Crisis of a decade ago. After a severe contraction of global output in 2020, world trade and output has recovered in the first nine months of this year. However, the crisis is still far from over, with more than 400,000 new cases reported every day, including more than fifty thousand in Southeast Asia. Our best hope remains the rapid and equitable deployment of coronavirus vaccines and coordinated multilateral action to sustain investment, trade and jobs as the infection is contained and progress is resumed toward achieving the SDGs in 2030.

In this short paper I would like to make two main points. First, because of the recent wave of infections in Southeast Asia, the region is likely to experience a delayed recovery in 2021 and 2022. Growth with accelerate this year, but less than in other regions, gaining traction in 2022 as tourism, transport and other services come back on stream. Second, Viet Nam can support growth, employment and incomes with a larger cash assistance program for vulnerable households without fear of inflation or a negative impact on the balance of payments.

I will begin with a brief discussion of global economic trends, offer some comments on the role of fiscal policy and close with some implications for economic policy in Viet Nam.

World Economic Trends

According to a recent UNCTAD report, the world economy contracted by 3.5 percent in 2020, with the advanced countries, which are heavily dependent on services, hit particularly hard (Table 1).[1] Southeast Asia contracted by 3.9 percent because of the loss of revenue from international tourism, a collapse of private sector investment and reduced activity in the construction and mining sectors. Viet Nam, which recorded growth of 2.9% for the year, was an outlier in the region thanks to early and effective control of the virus. UNCTAD forecasts growth in world output of 5.3% this year as the economy regains ground lost in 2020, but the recovery will slow in 2022. Despite above-trend growth in 2021-2022, at the end of 2022 the world economy will be USD 10 trillion smaller than it would have been in the absence of the Covid-19 pandemic. Southeast Asia's recovery will be delayed by the most recent wave of infections in the region, with growth accelerating in 2022.

The economic impact of Covid-19 was much larger than that of the Global Financial Crisis, especially in Southeast Asia, South Asia and Africa. In Southeast Asia, countries heavily dependent on tourism like Thailand, Malaysia and the Philippines were hit hard by travel restrictions. Oil, gas and coal producers had to endure extended periods of lower prices in 2020, although mineral and food export prices actually increased for the year as a whole. Private Investment was hit hard, especially in the services and construction sectors. A major problem throughout the region was the steep contraction in private

[1] UNCTAD Trade and Development Report 2021, *From Recovery to Resilience: The Development Dimension*, Geneva, September 15, 2021.

consumption because of the relatively muted fiscal response (see below). Slow consumption growth into 2022 will delay recovery the labor market and aggregate growth.

Table 1. Economic growth, 2019-2022

Country or region	2019	2020	2021f	2022f
World	2.5	-3.5	5.3	3.6
Developed	1.7	-4.7	4.7	2.9
Developing	3.7	-1.8	6.2	4.7
Asia	3.8	-1.1	5.9	4.7
East Asia	4.3	0.3	6.7	4.7
Southeast Asia	4.4	-3.9	3.5	4.7

Source: UNCTAD Trade and Development Report 2021 (September 15, 2021)

Rising commodity prices and some supply bottlenecks, notably in semiconductors, have triggered price inflation in some countries, especially the United States, as the recovery gathers pace. It is common to experience a short period of price inflation after a major crisis: for example, inflation accelerated immediately after the Global Financial Crisis in 2009 but then quickly died down. Europe and Japan, which have struggled with price deflation since the Global Financial Crisis—and in the case of Japan, even longer—price trends are still negative despite the recent round of increases. In the United States, policy makers will watch prices to see if inflationary expectations begin to affect wages. If that were to happen, interest rate rises could arrive earlier in 2022 than presently forecast. However, the employment to population ratio in the US is still low, suggesting that even with a robust recovery we are unlikely to see a sustained period of upward pressure on wages.

Accelerating price inflation in the United States is bad news for developing countries, especially countries that rely on portfolio capital flows to finance trade deficits. Developing country debt, especially if denominated in domestic currencies, become less attractive when interest rates rise in the advanced countries. The 2013 Taper Tantrum, when expectations of interest rate rises led to a spike in US Treasury yields and a reverse flow of capital out of the developing world, was a harsh lesson in the vulnerability of "emerging markets" to sudden shifts in international capital flows. Even countries that issue public debt in their own currencies are not safe, because in recent years global traders have become active participants in domestic bond markets. Countries like Indonesia rely on international investors for 40 percent of domestic bond sales, which leaves the country vulnerable to a sudden shift in sentiment. Foreigners do not participate in the domestic VND bond market, which provides some protection against a sudden stop of global capital inflows.

The rise in commodity prices was driven by China, which increased spending on infrastructure during the pandemic, lifting imports of metals like copper and iron. China has also increased imports of vegetable oils, wheat and soybean, lending further support to food prices. Drought conditions in South America reduced supplies of grains and other commodities. Fuel prices rebounded under the OPEC+ agreement, but if prices continue to rise US shale producers will increase supply, which would act to stabilize prices. The price of coal has surged in 2021, but the main causes are temporary and most observers expect the price rises to be short lived.

Table 2. Growth of commodity prices

Commodity	2017	2018	2019	2020	2021f
All commodities	17.4	16.0	-7.4	-15.9	43.5
Fuel	25.9	27.5	-12.6	-32.1	54.8

Minerals, ores and metals	11.3	1.3	6.2	15.5	34.6
Food	-1.3	-6.5	-2.0	6.5	28.1
Agricultural raw materials	5.3	-1.8	-3.9	-2.0	16.6

Source: UNCTAD Trade and Development Report 2021

International trade volumes fell by 5.6 percent in 2020, which was a less severe decline than initially anticipated. UNCTAD expects real growth of nearly ten percent in 2021. China recorded the most rapid growth of exports, but developing Asia was not far behind. However, the sharp rise in trade volumes registered in the first half of 2021 is not likely to continue, since it reflects rebuilding of inventories depleted in 2020 and a shift from services to goods in the advanced countries that is now likely to be rebalanced. High shipping costs resulting from infrastructure bottlenecks and shortages of some components will also act to cool down growth of export volumes.

Tourism, which accounts for one-fourth of all trade is services, remains depressed, with tourist arrivals still 85 percent below 2019 levels for the world as a whole, and 95 percent lower in Asia. The UN World Tourism Organization does not expect travel to reach 2019 levels until 2024. Airline passenger revenue was still down 74 percent from 2019 in the first quarter of 2021, although air cargo revenues are sharply higher.

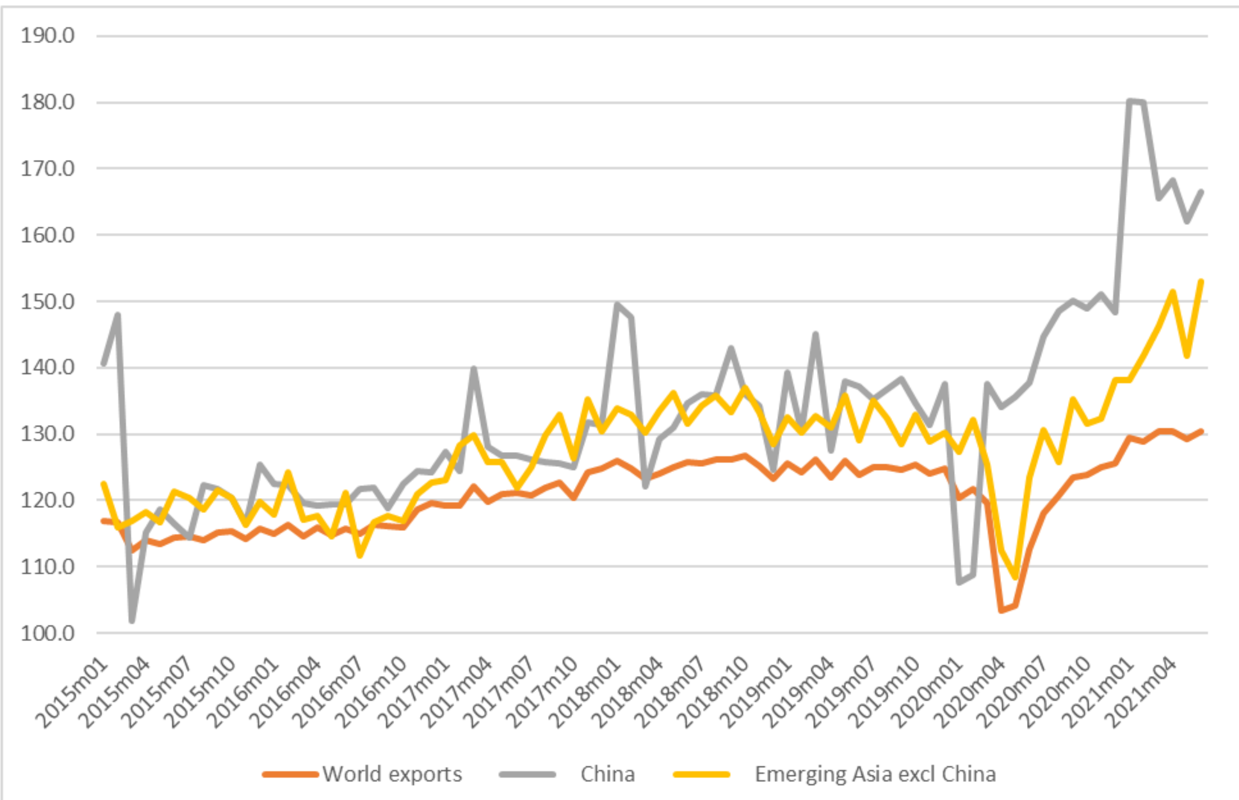

Figure 1. World export volumes 2015-2021 (2010=100)(Source: Netherlands Bureau for Economic Policy Analysis)

Fiscal policy

The Global Financial Crisis of 2008-2009 marked a turning point in economic policymaking. The severity of the crisis, and that fact that it emerged from the epicenter of global finance rather than from the periphery, shattered the prevailing consensus in favor of financial liberalization and the free movement of capital. Although fraudulent practices in the US mortgage markets were the immediate trigger of the crisis, there were deeper causes in play, including rising levels of economic inequality, excessive leverage, underinvestment and slow productivity growth and global imbalances.

As the crisis unfolded, and the advanced countries faced a genuine possibility of descent into a global depression, world leaders called for a coordinated, global fiscal stimulus to pre-empt a downward spiral in trade, employment and incomes. The US announced an immediate stimulus of 1.6% of GDP, and China's 4.3 percent program over two years put a floor under global commodity prices. But once the immediate crisis passed, the US and Europe, wary of further additions to public debt, shifted from stimulus to austerity, relying entirely on monetary policy to support demand growth.

The result of the early withdrawal of fiscal support was slower growth and rising asset prices. Buoyed by cheap credit and a dearth of viable investment opportunities, corporations and households ploughed money into equities and properties. Buy September 2021, US house prices had already passed their pre-crisis peak, and the S&P 500 was trading at three times 2007 levels despite the disruption of the coronavirus pandemic. China and the rest of East Asia continued to outperform other regions with higher levels of investment and trade surpluses generated by a shift in global manufacturing from West to East. Global growth decelerated from the pre-crisis trend, weighed down by slow growth of investment and consumer demand (Table 3).

Table 3. Average GDP growth and growth projections, 2001-2030 (Source: UNCTAD)

	2001-2007	**2010-2019**	**2023-2030**
World	3.54	3.13	2.54
China	10.96	7.80	4.59
East Asia excluding China	5.15	4.76	3.15
South Asia	6.72	5.89	3.64
Latin America	3.36	1.83	1.93
Africa	5.30	2.70	2.51

There is a danger that we have failed to learn the lessons of the Global Financial Crisis. During the early phases of the coronavirus pandemic, the immediate threat of economic collapse spurred advanced countries in action. They increased spending on health and social protection, reduced and rescheduled tax payments, created new mechanisms to replace private sector wages and channeled soft loans to small businesses. Additional spending and tax reductions amounted to ten percent of world GDP, supplemented by a monetary stimulus equivalent to six percent of GDP (Figure 2).

The fiscal response helped avert the worst-case scenario of a generalized collapse of trade, employment and incomes. However, as was the case during the Global Financial Crisis, the response was uneven and inadequate given the scale of the challenges facing the international economy. Despite repeated promises to "build back better," the advanced countries have resisted calls for a coordinated global recovery plan, meaningful debt relief for highly indebted countries and reform of the international financial architecture to discourage speculation and channel resources into socially productive investments, especially renewable energy systems and climate change mitigation and adaptation.

Production and distribution of coronavirus vaccines is still grossly unequal: as of mid-September, 5.6 billion vaccine doses have been administered, but only two percent in Africa.[2]

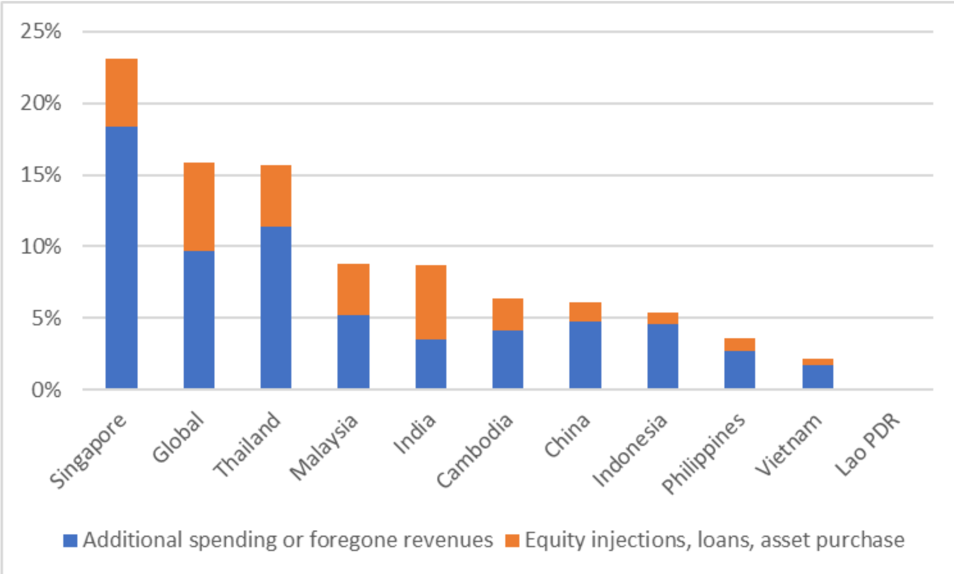

Figure 2. Fiscal response to covid-19 as percent of GDP, 2020-2021 (data as of June 5, 2021) (Source: IMF)

The absence of a coordinated fiscal response increases the likelihood that the post-pandemic period will return to the low-growth trend seen after the Global Financial Crisis. Forecasts generated by the United Nations Global Policy Model for 2023 to 2030 assume a reduction of fiscal activism after 2022, persistence of high levels of within-country inequality and reliance of loose monetary policy (Table 3). These forecasts indicate that combination of financialization, fiscal austerity and inequality will continue to weigh on growth in the post-pandemic period. In the absence of another massive fiscal stimulus in China, the growth deceleration in East Asia (excluding China) will be particularly severe, marked by declining investment rates and, in countries with chronic current account deficits, increased dependence on risky sources of capital inflows.

Implications for Viet Nam

Developing countries were largely left to their own devices to manage the economic impact of the pandemic, and they varied considerably in their capacity to mount a fiscal policy response comparable to the advanced countries. Even within Southeast Asia, additional spending on health and social protection ranged from a high of 18 percent of GDP in Singapore to zero in Lao PDR (Figure 3). Viet Nam increased spending on health and social protection by two percent of GDP from January 2020 to June 2021, according to the IMF.[3]

Viet Nam has introduced two fiscal measures since the beginning of the pandemic. Resolution 42/NQ-CP on supporting people affected by Covid-19 was issued in April 2020 and included a support package of 62 trillion VND to aid 20 million workers who had lost jobs due to the pandemic. A new VND 26 trillion support package was announced on July 1st, 2021 to help workers affected by lockdowns and social distancing during the most recent wave of infections (Resolution 68/NQ-CP). The Government has taken

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[2] Speech by UN Secretary-General Antonio Guterres at the opening of the General Assembly High Level Week, September 20, 2021 (https://unsdg.un.org/latest/stories/world-leaders-bts-join-guterres-call-get-sdgs-back-track).
[3] See https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19.

timely action to reduce the suffering of households that are without income due to loss of employment or earnings from self-employment.

However, there is evidence that the support package is neither large enough, nor broad enough in scope, to protect vulnerable households from income loss resulting from lockdowns and social distancing. A recent survey carried out by the Centre for Analysis and Forecasting of the Viet Nam Academy of Social Sciences found that the rate of transient income poverty surged from under 10% pre-crisis to 33.4% in August 2021 (based on the 2021-2025 poverty line issued by the Ministry of Labour - Invalids and Social Affairs). According to this report, ninety percent of respondents had not received support since the July 2021 package was approved, and that migrants, the self-employed and the homeless were not eligible for benefits. Thousands of households have resorted to reducing food consumption, including milk for infants and children.

An evaluation report of Resolution 68 carried out by the Institute of Labor Science and Social Affairs (Ministry of Labor, Invalids and Social Affairs) confirms that the coverage rate of cash assistance programs is low because the program design excludes vulnerable groups such as migrants without registration status and self-employed workers in the informal sector. The report also notes that coverage varies among provinces because the program relies on local authorities to mobilize funding. Cumbersome regulations for recipients and employers have also reduced coverage and disbursement rates.

As shown in Figure 2, Viet Nam's fiscal response to the crisis is small relative to neighboring countries. The rationale for the limited fiscal effort is the need to contain government budget deficits to prevent the debt to GDP ratio from rising and potentially causing inflation and balance of payments deficits. While this logic holds during normal times, it should be recognized that social distancing and lockdowns are a very unusual situation that calls for extraordinary measures. While in most years growth of private consumption accounts for 60 to 70 percent of aggregate economic growth, during lockdowns consumption is suppressed by restrictions on movement and closures of restaurants and retail outlets. Consumption contributed relatively little to output growth in 2020 as household were forced to rein in spending during the pandemic (Figure 3). Consumption recovered in the first half of 2021, but we can expect a steep drop in spending in the second half as households cope with restrictions to control the spread of the latest wave of infections.

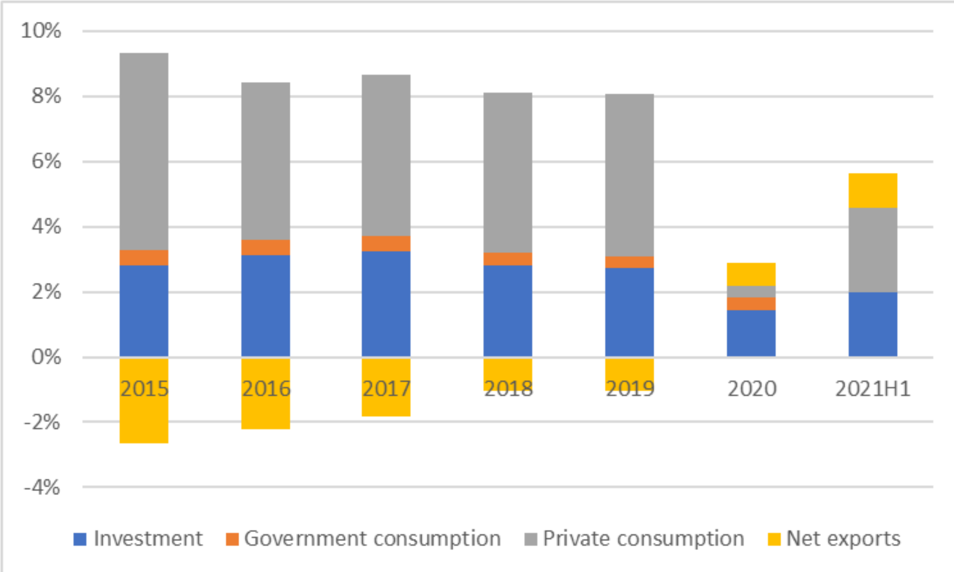

Figure 3. Contributions to real economic output growth (Source: GSO)

Spending reductions due to lockdowns and social distancing give rise to forced or unplanned savings, since planned consumption cannot be carried out. Because a large proportion of the goods and services that are normally consumed by households are domestically produced, forced savings represent a loss of income to the domestic companies producing, transporting and selling those goods and services. The effect of lower spending is amplified as reductions in the first round of spending have a knock-on effect on successive rounds. So, for example, when a household cuts spending on prepared meals, the restaurant owner reduces her purchases of meat and noodles, and the payment of wages for cooks and cleaners. This decreases the incomes of meat and noodle producers, the wages paid to their workers, and the incomes of businesses that sell goods and services to these workers. Each round of reduced spending amplifies the impact of the initial reduction in spending. This is the multiplier effect, the size of which depends on the proportion of income that households normally spend on domestically produced goods and services. The multiplier is greater than one, which means that the ultimate contribution to aggregate demand of successive spending rounds is greater than the initial increase in spending.

Businesses pay taxes on earned income, so a reduction in spending also reduces government revenue. Stimulus packages that increase domestic spending partly pay for themselves because they increase domestic economic activity and therefore generate tax revenue.

Another important implication of forced savings is that some of the reduced spending accumulates as cash balances and inventories. These balances are a drain on aggregate demand unless they are mobilized by the sale of public debt, the proceeds of which are spent in ways that increase domestic consumption and investment. The additional public borrowing does not generate price inflation because these cash balances are idle, in other words, the government is not competing with other borrowers for use of these funds. Nor will the additional government spending create shortages of labor, investment or consumption goods, because the economy is operating far below its potential. Therefore, the risk of price inflation is small.

Another argument against carrying out a large cash assistance program is that a portion of the extra spending will be used for imports, which could have negative implications for the balance of payments.

However, as shown in Figure 4, Viet Nam's trade balance has remained in surplus throughout the pandemic despite the loss of tourism income, because exports rebounded quickly from their low point in the second quarter of last year. While imports recovered in the first half of 2021, this is unlikely to be the case in the second half given the suppression of consumption from July. Moreover, the share of the cash assistance spent on imports can be kept in check by directing support to lower- and middle-income households that spend most of their earnings on domestically produced goods and services like food, utilities, housing and essential services like education and healthcare.

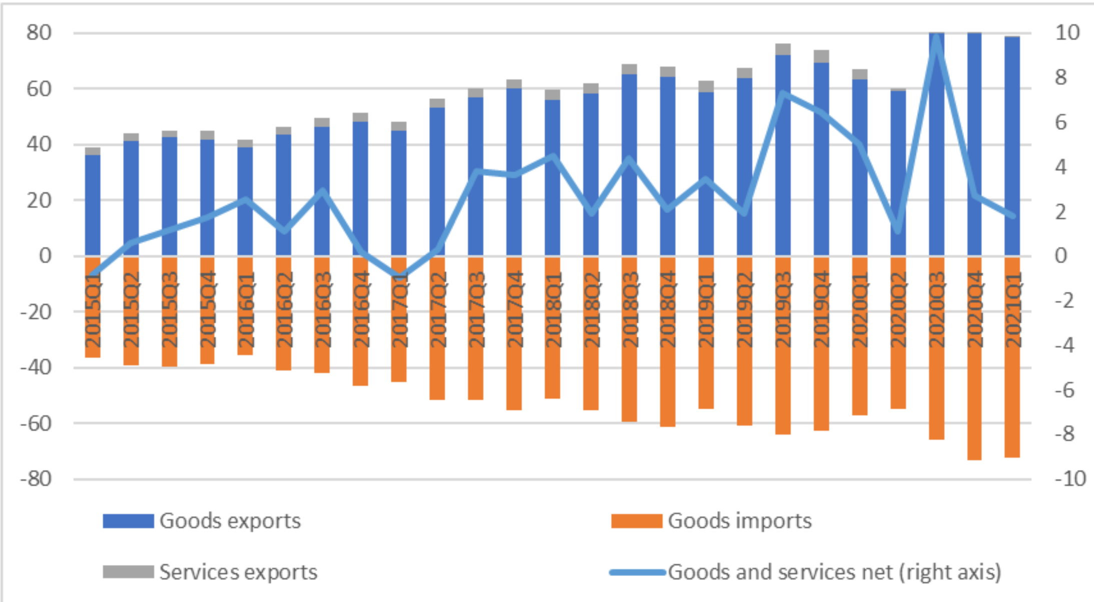

Figure 4. Trade in goods and services, USD billions (IMF)

Because of forced saving, the Government can significantly increase the size of the cash assistance program without risk of increasing inflation or interest rates. A cash assistance program of 5% of *quarterly* GDP disbursed over the final months of 2021 (or approximately VND 77 trillion) is analogous to the levels of support provided by other countries in the region. As discussed above, the multiplier effect of additional consumption spending is greater than one, which means that a 77 trillion VND package would have a much larger impact on total private consumption and national output.

To achieve the twin objectives of supporting vulnerable households and stimulating economic growth, the cash assistance program should be launched as quickly as possible. The quickest way to deliver this support is to provide an immediate child benefit to (i) children under 6 years old (about 11 million children) on presentation of the child's birth certificate; (ii) pregnant women; (iii) elderly people from 60 years of age (about 11.5 million older people) including elderly people from 80 years of age that are beneficiaries of regular cash assistance programs without pensions; (iv) and people with disabilities. Administrative requirements should be kept to a minimum, and an electronic register of individuals should be compiled listing households and individuals who have received support. Cash assistance can be delivered monthly or in one payment for the final three months of 2021. The amount can be linked to the minimum subsistence requirements in Decree 20/2021/NĐ-CP (replacing Decree 136/2013/NĐ-CP).

One of the important lessons from the rapid spread of the Delta variant is that setbacks are not only possible, but they are to be expected. Therefore, in addition to delivering immediate support, preparations must also be made for medium-term programs to sustain growth and private consumption if necessary. Supplemental programs could address issues that cannot be managed in the short term, for example:

- An accelerated transition to electronic registration for social assistance programs based on unique national identification numbers rather than residence;
- A rent replacement scheme that provides grants to tenants to pay rent to ensure that low-income workers are not evicted from rented accommodation during lockdowns because of loss of earnings;
- A program to distribute inexpensive, domestically produced tablet computers to all school aged children who will need these devices for home schooling resulting from the pandemic;
- Provision of vouchers for free or subsidized access to specific domestically produced goods, including rice, fruit and vegetables, cooking oil, clothing, books and school supplies.

The objective of these polices and programs is to aid disadvantaged people in case of a longer lockdown, and to sustain domestic consumption. The emphasis is on goods and services that are most needed that are domestically produced, which would stimulate domestic production, create jobs and increase Government revenue.

Conclusion

The global economy recovery from the Covid-19 pandemic has begun to gather pace, but conditions are still far from normal. The number of new cases remains high, including in Southeast Asia and Viet Nam, and the appearance of new variants of the virus cannot be ruled out. Other risks threaten the recovery. Accelerating inflation in the United States could lead to higher interest rates and a reversal of capital flows from developing to advanced countries. The absence of a coordinated global recovery plan increases the likelihood that the fiscal stimulus—which has been instrumental to the recovery of global trade—will be withdrawn too soon. Tourism and travel are unlikely to recover before 2024, and even that date may be optimistic if a new wave of infections emerges. The production and distribution of vaccines is slow and unequal, which will hamper the recovery of developing countries, many of which are now suffering the highest caseloads.

Private consumption will be suppressed in the second half of the year in Viet Nam, which will reduce incomes, employment and tax revenue. To counter the effects of forced saving, UNDP proposes a cash assistance program of 5% of quarterly GDP, to be implemented as soon as possible in the final months of 2021. The emphasis of this program should be on rapid disbursement, especially to people who are currently suffering from extremely difficult circumstances due to the pandemic. A universal cash transfer for the elderly and children would achieve this immediate objective. Also, medium-term support policies need to be designed now to prepare for the possibility of further lockdowns and social distancing measures in the future.