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Factors Affecting Inflation in Vietnam

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Abstract
Inflation is a common macroeconomic phenomenon with far-reaching effects on all aspects of social life. In Vietnam, inflation not only reflects market supply-demand fluctuations but is also influenced by complex factors like monetary and fiscal policies, exchange rates, global commodity prices, and consumer sentiment. In the context of increasing global integration, controlling inflation stably and effectively is a key objective of national economic policy. This article analyzes and clarifies the main factors influencing inflation in Vietnam in recent years. This contributes to a better understanding of the mechanism of inflation in the Vietnamese economic context and provides some suggestions and recommendations for policy planning and management to sustainably and effectively control inflation.

Keywords: Inflation, Vietnam

1. Concept and Classification of Inflation

Concept of Inflation

Inflation and unemployment are persistent issues in almost every economy today. Economists have likened inflation and unemployment to two chronic diseases of the modern economy. Some national leaders have considered inflation "public enemy number one" and made its reduction a top economic priority. It's important to distinguish between three concepts: inflation, deflation, and disinflation.

- **Inflation:** The state where the general price level in an economy increases over a certain period of time.
- **Deflation:** The state where the general price level in an economy decreases over a certain period of time.
- **Disinflation:** The state where the general price level in an economy increases, but at a slower rate than before.

The degree of inflation is measured by the inflation rate.

Classification of Inflation

Based on the inflation rate, inflation can be divided into three types:

- **Moderate Inflation (also known as single-digit inflation):** When the prices of goods and services increase slowly, below 10% per year, the currency is relatively stable, and the economy is stable. For example, if the average price of essential consumer goods increases by about 5-7% in a year, people feel that prices have risen but it doesn't cause too much disruption to their daily spending, and the economy remains relatively stable.
- **Galloping Inflation (also known as two or three-digit inflation):** When the prices of goods and services increase from 10% to 999% per year. For example, in a country experiencing a rapid price increase, such as prices for goods doubling or tripling in a year, people begin to worry about the purchasing power of their money and tend to hoard goods or switch to other, more stable assets. Businesses face difficulties in pricing their products and planning long-term business strategies.
- **Hyperinflation (four digits or more):** When the inflation rate is 1000% per year or more, the currency loses its value severely, the economy becomes unstable, life is difficult, and everything becomes scarce except for paper money. For example, in the 1980s in Bolivia, as mentioned in the text, inflation reached 12,000% per year, meaning the prices of goods and services increased hundreds, or even thousands, of times in a year. The currency lost its value so severely that people had to carry bags of cash to buy daily necessities. The economy was in severe disarray, business activities stagnated, and people's lives were extremely difficult. Another example is the hyperinflation in Zimbabwe in the late 2000s, where prices increased hourly and the local currency lost almost all its value.

2. The Relationship Between Inflation and Interest Rates
Impact of Inflation on Interest Rates

- **Interest rates rise when inflation is high:** Central banks often raise interest rates to control inflation. When inflation is high, and the prices of goods and services increase, the central bank adjusts interest rates to limit spending in the economy, thereby reducing upward price pressure.
- **Real interest rates and nominal interest rates:** The nominal interest rate is the interest rate a borrower pays, while the real interest rate reflects the actual rate of return after adjusting for inflation. When inflation rises, the real interest rate decreases because the nominal interest rate may not be enough to compensate for the increase in inflation.
- **Impact on consumers and businesses:** When interest rates increase due to inflation, the cost of borrowing for both businesses and consumers will be higher. This can lead to a decrease in consumption and investment, resulting in slower economic growth.
- **Impact on investment:** High interest rates can reduce the attractiveness of investing in long-term projects because the cost of borrowing becomes more expensive. This can lead to reduced investment and slow down economic development.

Relationship between Inflation and Interest Rates in Monetary Policy

- **High interest rates reduce inflation:** When the Central Bank raises interest rates, the cost of borrowing for businesses and consumers becomes higher. This reduces spending and investment in the economy, thereby decreasing aggregate demand and helping to curb inflation.
- **Low interest rates increase inflation:** Conversely, when the Central Bank lowers interest rates, the cost of borrowing decreases, encouraging spending and investment. This can lead to a strong increase in aggregate demand, which may increase inflation if not controlled.
- **Tightening monetary policy (raising interest rates):** When the economy shows signs of high inflation, the Central Bank can implement a tightening monetary policy by increasing interest rates. This will reduce the rate of economic growth and curb prices.
- **Loosening monetary policy (lowering interest rates):** In the case of an economic recession or low inflation, the Central Bank can lower interest rates to stimulate spending and investment, promote economic growth, and stabilize prices.

3. The Relationship Between Inflation and Money
Money Supply and Inflation

- **Concept of money supply:** The money supply is the total amount of currency in circulation in an economy at a specific time. It includes various components, from physical currency to bank loans that can be easily converted into cash. The money supply reflects the liquidity of the economy and is one of the most important variables of macroeconomics.
- **Relationship between money supply and inflation:** The relationship between money supply and inflation is a crucial issue in macroeconomics. When the rate of money supply growth is too high and other factors remain unchanged, inflation can occur. According to the quantity theory of money, any increase in the money supply will increase nominal GDP. According to the formula MS * V = P * Y, inflation (% change in P) is highly dependent on the change in money supply (% MS). If the money supply increases faster than the actual output under normal conditions, inflation can occur.

Impact of Inflation on the Value of Money

When inflation occurs, it leads to several impacts:

- **Reduced purchasing power:** Inflation causes currency to lose value, meaning consumers have to spend more to buy the same amount of goods and services. When prices rise, the purchasing power of money decreases, creating difficulties for those whose incomes do not increase in line with inflation.
- **Impact on savings:** When inflation is high, the value of cash savings will be eroded. People tend to seek other investment methods to protect their assets from the devaluation of money, leading to a shift of capital from cash to assets like real estate, gold, stocks, etc.
- **Difficulties in accounting:** Inflation causes instability in business accounting. When prices change continuously, businesses face difficulties in pricing products, forecasting production costs, and planning finances, which affects profits and production activities.
- **Impact on the banking system:** When inflation increases, depositors may no longer trust the value of the currency, leading to a decrease in bank deposits. Banks will face difficulties in maintaining normal operations due to a lack of capital, and the lending rate also decreases.
- **Exchange rate fluctuations:** Inflation can lead to fluctuations in the exchange rate. If inflation in one country is higher than in others, that country's currency may depreciate against other currencies, making exported goods and services more expensive while imported goods are cheaper.

Fisher Equation and Fisher Effect
Distinguishing Nominal and Real Interest Rates

- **Nominal interest rate (r):** The interest rate on loans in the market.
- **Real interest rate (rt):** The percentage increase in the purchasing power of capital, calculated by the formula: $rt=r-Ie$.

Fisher Equation

The Fisher equation is an important economic tool used to describe the relationship between the nominal interest rate, the real interest rate, and the inflation rate, expressed as:
$r=rr+If$. Thus, the nominal interest rate equals the sum of the real interest rate and the inflation rate.

Fisher Effect

The Fisher effect shows that when the inflation rate increases by 1%, the nominal interest rate also increases by 1%. This means there is a close relationship between the inflation rate and the nominal interest rate.

4. Impact of Inflation on Economic Structure and Efficiency
Impact on Economic Structure

Inflation has and is creating profound changes in the economic structure of many countries, including Vietnam.

These impacts are reflected in the shift in structure by sector, economic component, and territory.

- **Shift by sector:** The proportion of agriculture in GDP has gradually decreased, giving way to the strong development of industry and services. For example, the proportion of the agricultural sector in Vietnam's GDP decreased from about 40% in the 1990s to less than 12% in 2023.
- **Impact on the structure by economic component:** The private and foreign-invested (FDI) sectors are increasingly becoming the main drivers of the economy, replacing the previously dominant state-owned sector. For example, large foreign corporations like Samsung, Intel, and Honda have contributed to increasing production capacity and technology transfer in Vietnam.
- **Impact on the structure by territory:** Economic restructuring is not uniform across regions. Major urban areas like Hanoi and Ho Chi Minh City have become centers for industry and services, while many rural areas remain primarily agricultural. This leads to a disparity in income and living conditions between regions.

Impact on Economic Efficiency

- **Increased labor productivity:** The application of advanced technology such as automation, AI, and Big Data helps businesses optimize production processes, reduce working time, and increase output.
- **Reduced production and transaction costs:** The use of new technologies also significantly reduces production and transaction costs. For example, e-commerce platforms like Tiki and Shopee have reduced the cost of retail space and optimized warehousing, saving operating costs and enhancing competitiveness.
- **Increased business competitiveness:** Businesses that quickly adopt new technologies gain a significant competitive advantage. However, this also poses challenges for traditional businesses that have not adapted in time.

5. Solutions to Fight Inflation

Limiting Aggregate Demand

Aggregate demand is the total value of goods and services that consumers, businesses, the government, and foreigners are willing to buy in an economy at a certain price level. Solutions to limit aggregate demand include measures to control the level of consumption and investment, such as tightening monetary policy and fiscal policy, and controlling prices/wages.

- **Tightening monetary policy:** The central bank can increase interest rates to reduce the amount of money in circulation. This will reduce consumer spending and investment, thereby limiting aggregate demand.
- **Tightening fiscal policy:** The government can cut public spending or increase taxes to reduce consumer spending and investment. This will decrease total demand in the economy, helping to curb inflation.

Increasing Aggregate Supply

Aggregate supply is the total value of goods and services that producers are willing to provide in an economy at a certain price level. Solutions to increase aggregate supply include measures to enhance the economy's production capacity.

- **Investing in infrastructure and technology:** Investing in infrastructure like transportation and energy can increase labor productivity, thereby strengthening the economy's supply capacity.
- **Training human resources and improving labor quality:** The government and businesses need to invest in vocational training and upskilling workers to increase labor productivity.
- **Encouraging investment and policy reforms:** The government needs to create a favorable investment environment, reduce administrative and tax barriers to attract domestic and foreign capital.
- **Increasing exports:** Expanding export markets helps increase aggregate supply by boosting the production of goods to meet international demand.

6. Conclusion

Inflation is a complex economic phenomenon influenced by various factors. In Vietnam, the main factors affecting inflation include production costs (especially raw material prices), state monetary and fiscal policies, market supply and demand, exchange rates, and external factors like global economic fluctuations. To stabilize the macro economy and ensure the public's livelihood, managing and controlling inflation is a crucial and long-term task for the Government and the State Bank. At the same time, increasing production capacity and enhancing the economy's self-reliance are fundamental solutions to mitigate future inflationary pressure.

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