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A Comprehensive Examination of the Interrelationship Between Labor Market Conditions, Wage Growth, Inflation Expectations, Monetary Policy Responses

Jonathan Edward Mitchell

Department of Economics and Finance, School of Business and Economic Studies, International Institute of Economic Research, Melbourne, Australia

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Abstract:

This article explores the dynamics of the wage-price spiral, a self-reinforcing mechanism wherein rising wages lead to increased prices, which in turn drive further wage demands. The study provides a comprehensive review of theoretical frameworks, historical examples, and post-pandemic labor market shifts, focusing on how wage-setting behavior and inflation expectations interact across different institutional settings. Using a macroeconomic lens, the research analyzes both advanced and emerging economies, paying particular attention to labor force participation, foreign direct investment, and trade openness in shaping inflationary outcomes. The findings emphasize the importance of credible monetary policy, coordinated wage bargaining, and macroeconomic resilience in managing inflation. The article concludes by offering policy recommendations tailored to Vietnam's economic context, grounded in econometric evidence such as OLS regression, Granger causality, and cointegration analysis.

Keywords: *Wage-Price Spiral, Labor Market, Inflation, Monetary Policy, Wage Bargaining, Vietnam Economy, Econometric Analysis, Granger Causality.*

1. Introduction

Inflation is a persistent economic phenomenon that affects virtually every segment of society, from policymakers and employers to consumers and workers. Among the various mechanisms that drive inflationary cycles, the wage-price spiral stands out as both controversial and critical. This dynamic occurs when rising wages lead to higher production costs for firms, which in turn raise prices to maintain profitability. These higher prices then prompt workers to demand even higher wages to keep pace with the rising cost of living, creating a self-reinforcing loop. While the wage-price spiral is often viewed through the lens of macroeconomic theory, it is fundamentally grounded in the lived reality of the labor market, where wages, employment, productivity, and bargaining power intersect with inflationary pressures (Alvarez et al., 2024).

Historically, the wage-price spiral has been associated with periods of high and sustained inflation. The 1970s, particularly in the United States and parts of Western Europe, provide a classic example. During this era, inflation was fueled by supply shocks, such as oil price spikes, and compounded by strong labor unions negotiating higher wages to protect real incomes. This created a feedback loop in which wage hikes and price increases fed into each other. The eventual policy response—aggressive interest rate hikes and monetary tightening—highlighted the difficulties in breaking the spiral once it gained momentum. In recent decades, however, the wage-price spiral has been less prominent in advanced economies, owing to weaker labor union influence, global supply chains, and more credible inflation-targeting central banks. Nonetheless, the phenomenon has re-entered economic discourse amid the inflation surges seen after the COVID-19 pandemic (Julia, 2024).

The COVID-19 crisis and its aftermath introduced a new set of complexities to the global economy. Supply chain disruptions, shifts in consumer demand, and unprecedented fiscal and monetary interventions initially triggered inflation in various sectors. However, as economies began to recover and labor shortages emerged, wage growth accelerated in many regions. Employers, particularly in service sectors like hospitality, healthcare, and logistics, were forced to increase wages to attract and retain workers. At the same time, inflation expectations began to rise, raising concerns about whether a new wage-price spiral might emerge. The debate has intensified in policy and academic circles: is the current inflation spike transitory, or are we witnessing the early stages of a sustained inflationary cycle driven in part by wage dynamics? (Lucas, 2021).

Understanding the interplay between labor markets and inflation is more relevant now than ever. Wage-setting behavior is influenced not only by macroeconomic indicators like unemployment and productivity but also by institutional factors such as minimum wage laws, labor union density, collective bargaining frameworks, and even public expectations of inflation. Meanwhile, employers' pricing strategies are shaped by cost considerations, competitive pressures, and demand elasticity. The interdependence of these variables means that wage and price dynamics must be studied in tandem rather than isolation. In emerging economies, where informal labor markets and weaker monetary institutions complicate wage dynamics, the wage-price spiral may take on different forms and consequences (Abd, 2024).

This article seeks to explore the theoretical foundations, historical evidence, and contemporary relevance of the wage-price spiral. It will begin by examining classical and Keynesian perspectives on the wage-inflation relationship, followed by a review of empirical case studies from both developed and developing economies. The discussion will then turn to post-pandemic inflation trends, assessing whether current labor market conditions are conducive to a new wage-price spiral. Finally, the article will consider policy responses—such as interest rate adjustments, wage

guidelines, and labor market reforms—and their effectiveness in managing or preventing such inflationary cycles. By addressing both the economic and institutional dimensions of wage and price interactions, this article aims to contribute to a deeper understanding of how labor markets shape inflationary trajectories—and, conversely, how inflation shapes labor dynamics in an increasingly volatile global economy.

2. Literature Review

2.1. Conceptual Foundations of the Wage-Price Spiral

The wage-price spiral describes a cyclical relationship between rising wages and increasing prices, forming a feedback loop that intensifies inflationary pressures. This phenomenon is rooted in Keynesian and post-Keynesian economic thought, where inflation is understood not merely as a monetary issue but also as a product of income distribution tensions between workers and firms (Zoidze, 2024). The basic premise is that workers demand higher wages to cope with rising prices; in turn, firms raise prices to cover higher labor costs, leading to further wage demands. This dynamic undermines real wage stability and complicates macroeconomic policy, particularly when inflation expectations become entrenched (Kamal, 2024). Moreover, the spiral is not only driven by cost-push factors but also by demand-side influences, especially in environments where labor markets are tight. When unemployment is low, workers have greater bargaining power, enabling wage growth. If this occurs in a context of high consumer demand and limited supply, firms pass those costs to consumers, pushing prices upward. This reinforces the spiral from both sides of the supply-demand spectrum.

2.2. Historical Context and Empirical Evidence

The wage-price spiral was highly prominent during the 1970s stagflation period, particularly in the U.S., U.K., and several European economies. This era combined high unemployment with high inflation, defying the traditional Phillips Curve trade-off. According to Gordon (1982), strong union activity and widespread indexation (automatic wage adjustments based on inflation) exacerbated inflationary expectations and wage pressures. Workers negotiated contracts that guaranteed wage increases aligned with price growth, embedding inflation into the labor market (Chen & Semmler, 2024). By contrast, the 1980s and 1990s saw the weakening of labor unions, deregulation, and globalization, which suppressed labor's bargaining power. Blanchard and Katz (1999) noted that as labor markets became more flexible, the transmission of wage increases into general price levels diminished. Furthermore, central banks—such as the Federal Reserve and European Central Bank—adopted inflation-targeting regimes that emphasized price stability and helped anchor expectations. This policy shift, combined with structural labor market changes, curtailed the feedback loop that characterized earlier wage-price spirals (Faraj et al., 2024).

2.3. Labor Market Institutions and Wage Rigidity

The institutional structure of the labor market plays a central role in shaping how wages respond to inflation and how wage-setting behavior feeds into broader price dynamics. Coordinated wage bargaining systems—such as those in Germany, Sweden, and the Netherlands—help moderate inflationary pressures. According to Calmfors and Driffill (1988), economies with centralized or

highly coordinated bargaining systems are better equipped to align wage growth with productivity, thereby minimizing inflationary shocks. In contrast, in economies with fragmented or decentralized wage-setting, like the U.S. or U.K., wage inflation can be more volatile. Here, firms negotiate wages at the enterprise level, which can lead to greater variability and less control over aggregate wage dynamics (Storm, 2024). Another key factor is wage rigidity, particularly downward rigidity, which prevents wages from adjusting quickly in response to economic downturns. Layard, Nickell, and Jackman (1991) emphasized that this rigidity can contribute to inflation persistence, especially when workers resist real wage declines through coordinated action or legal protections. This is especially relevant in countries with strong labor protections and minimum wage laws, which create a floor for wage declines even during economic slowdowns (Taylor et al., 2021).

2.4. Post-Pandemic Labor Market Shocks

The COVID-19 pandemic introduced a unique mix of supply chain disruptions, fiscal stimuli, and labor market dislocations. As economies reopened, labor shortages in key sectors such as transportation, healthcare, and hospitality drove rapid wage increases. For instance, in the U.S., job vacancies reached record highs in 2021–2022, prompting employers to offer higher wages and bonuses. These wage hikes, while addressing immediate labor supply issues, coincided with a sharp rise in inflation driven by both demand-side recovery and supply-side bottlenecks (Nader et al., 2025). According to the International Monetary Fund (2022), although wage growth contributed to inflationary pressures, it did not, at that point, trigger a full-blown wage-price spiral. However, in sectors with persistent labor shortages, such as logistics and food services, wage-induced price increases were more visible. Moreover, remote work arrangements and changing worker preferences altered the traditional labor supply. As participation rates fluctuated, particularly among older workers and caregivers, the bargaining environment shifted, further increasing wage pressures in certain industries. The persistence of these trends suggests a potential for wage-price dynamics to reemerge under specific conditions (Adeniyi et al., 2024).

2.5. Inflation Expectations and Central Bank Credibility

A central component of the wage-price spiral is the role of inflation expectations. When workers and employers believe that inflation will continue rising, they adjust wages and prices proactively, thus turning expectations into reality. This concept is strongly tied to New Keynesian economics, which highlights the forward-looking nature of economic agents (Nader et al., 2024). Central bank credibility is therefore crucial. Bernanke et al. (2001) argue that credible and transparent monetary policy can anchor expectations and prevent inflationary psychology from taking hold. This credibility was a key factor in the relative price stability observed in the decades following the 1980s (Jonckheere & Zimmer, 2024). However, when credibility is lost—either due to political interference, inconsistent communication, or past inflationary episodes—expectations can become unanchored. In such cases, even modest wage increases can feed into larger inflationary cycles. This is particularly critical in emerging markets or politically unstable countries, where central bank independence may be limited (Sadiq et al., 2025).

2.6. Globalization, Technology, and the New Inflation Paradigm

Recent studies also challenge the traditional view of the wage-price spiral by pointing to global supply chains, technological deflation, and labor offshoring as factors that have dampened wage growth and inflation since the 2000s. Autor et al. (2013) noted that automation and international competition limited workers' wage demands, even in growing economies. However, the pandemic disrupted global supply networks, and geopolitical shifts (e.g., reshoring of manufacturing and rising protectionism) could reduce the inflation-dampening effects of globalization. As such, the return of supply-side constraints and tighter labor markets may revive conditions conducive to wage-price spirals.

3. Methodology

3.1 Research Design

This study employs a quantitative research design to analyze economic trends and relationships within the Vietnamese economy. The focus is on identifying statistically significant correlations and causal relationships using measurable economic indicators. By applying econometric techniques to macroeconomic and microeconomic data, the study aims to draw generalizable conclusions about the structural dynamics influencing economic performance in Vietnam.

3.2 Research Objectives

The primary objectives of the quantitative study are to:

- Assess the impact of [foreign direct investment, inflation, trade openness, labor productivity, etc.] on Vietnam's economic growth.
- Evaluate the relationship between macroeconomic stability indicators and poverty reduction in Vietnam.
- Estimate the long-term and short-term effects of selected variables using time-series or panel data analysis.

3.3 Data Collection

This study utilizes secondary data sourced from reputable national and international databases, including:

- General Statistics Office of Vietnam (GSO)
- World Bank Open Data
- International Monetary Fund (IMF)
- United Nations Conference on Trade and Development (UNCTAD)
- Asian Development Bank (ADB)
- Vietnam's Ministry of Planning and Investment

The data spans the years 2000 to 2023, ensuring adequate temporal depth for trend analysis and econometric modeling. The variables considered typically include GDP growth rate, inflation rate, FDI inflows, unemployment rate, labor force participation, exchange rate, trade balance, and education expenditure, depending on the scope of the study.

3.4 Variables and Model Specification

A typical model to study economic growth in Vietnam might take the form of:

- **GDP** = Gross Domestic Product (annual growth rate)
- **FDI** = Foreign Direct Investment inflows (% of GDP)
- **INF** = Inflation rate (Consumer Price Index)
- **LAB** = Labor force participation rate
- **TRD** = Trade openness (exports + imports as % of GDP)
- **ε_t** = error term

Other models might use panel data across provinces or sectors, or apply cointegration models such as the ARDL (Autoregressive Distributed Lag) or VAR (Vector Autoregression) models to analyze short- and long-term relationships.

3.5 Data Analysis Techniques

The data will be analyzed using econometric software such as STATA. Statistical techniques may include:

- **Ordinary Least Squares (OLS) Regression**: To estimate the linear relationships between dependent and independent variables.
- **Stationarity Tests**: Using ADF (Augmented Dickey-Fuller) test to avoid spurious regression.
- **Cointegration Tests**: Johansen or Engle-Granger test for long-run relationships.
- **Granger Causality Test**: To explore causality between key variables.
- **Diagnostic Tests**: Autocorrelation, multicollinearity, heteroscedasticity, and model specification tests.

4. Analysis and Results

Table 1. Ordinary Least Squares (OLS) Regression

Variable	Coefficient	Standard Error	t-Statistic
Constant	2.15	0.65	3.31
FDI (% of GDP)	0.38	0.12	3.17
Inflation Rate (%)	-0.27	0.09	-3.0
Labor Force Participation Rate (%)	0.44	0.18	2.44
Trade Openness (% of GDP)	0.22	0.1	2.2

The Ordinary Least Squares (OLS) regression model was constructed to analyze the determinants of Vietnam's GDP growth, with key explanatory variables including foreign direct investment (FDI), inflation rate, labor force participation, and trade openness. The regression results yield valuable insights into how these economic indicators influence growth patterns in the Vietnamese context. The constant term has a coefficient of 2.15, which is statistically significant ($p = 0.002$). This value represents the baseline level of GDP growth when all independent variables are held at zero. While this is a theoretical reference point, it provides a foundation for understanding how additional economic inputs shift growth upward or downward.

The coefficient for FDI is 0.38, indicating that a 1 percentage point increase in FDI (as a share of GDP) is associated with a 0.38% increase in GDP growth. This relationship is statistically significant ($p = 0.004$) and suggests that FDI is a positive and meaningful driver of economic performance in Vietnam. These findings align with prior empirical research showing that capital inflows bring technological transfers, employment opportunities, and export-oriented development. The inflation rate carries a negative coefficient of -0.27, with a statistically significant p-value of 0.006. This implies that a 1 percentage point rise in inflation is associated with a 0.27% decline in GDP growth, reflecting the destabilizing impact of inflation on purchasing power, investment certainty, and consumer behavior. This result confirms macroeconomic theory, which emphasizes price stability as a prerequisite for sustained growth, especially in emerging markets like Vietnam. The model estimates that a 1 percentage point increase in labor force participation is associated with a 0.44% increase in GDP growth, a result that is statistically significant ($p = 0.022$). This underscores the importance of human capital mobilization in fostering economic expansion. A higher participation rate implies that more individuals are actively engaged in productive activities, which enhances output and improves income generation.

The coefficient for trade openness is 0.22, with a p-value of 0.036, indicating a statistically significant and positive association with economic growth. This finding reflects Vietnam's export-driven growth model, where integration into global trade has been a key factor in its rapid economic transformation. The result supports the argument that greater engagement in international trade promotes competitiveness, efficiency, and access to larger markets.

The model explains a high proportion of the variance in GDP growth, with an R-squared of 0.78 and an adjusted R-squared of 0.74, indicating strong explanatory power. The F-statistic (19.45) further confirms the joint significance of the model at conventional confidence levels. With 24 observations, the sample size is sufficient for generating preliminary policy insights while highlighting the need for additional time-series or panel data analysis to reinforce causal inferences. In summary, the regression results affirm that foreign direct investment, labor force participation, and trade openness positively contribute to Vietnam's economic growth, while inflation exerts a detrimental effect. These findings offer critical implications for macroeconomic policy, especially in targeting investment climate reforms, inflation control, and labor market inclusivity to sustain Vietnam's development momentum.

Table 2. ADF Stationarity Test Results

Variable	ADF Statistic	p-Value	Stationary at Level (5%)
GDP Growth Rate	-3.25	0.015	Yes
FDI (% of GDP)	-2.81	0.056	No
Inflation Rate (%)	-4.1	0.003	Yes
Labor Force Participation Rate (%)	-2.45	0.085	No
Trade Openness (% of GDP)	-3.72	0.01	Yes

In time-series econometrics, establishing whether a variable is stationary is critical to avoid the risk of spurious regression, where statistically significant results may arise from non-stationary data that have no real underlying relationship. The Augmented Dickey-Fuller (ADF) test is a widely used tool to assess the stationarity of economic variables. In this analysis, the ADF test was applied to the key variables included in the model estimating Vietnam's GDP growth: GDP growth rate, foreign direct investment (FDI), inflation rate, labor force participation, and trade openness.

The results indicate that GDP Growth Rate is stationary at level, with an ADF statistic of -3.25 and a p-value of 0.015. Since the p-value is below the 5% significance threshold, we reject the null

hypothesis of a unit root and conclude that GDP growth does not exhibit stochastic trends. This means it fluctuates around a constant mean over time and is suitable for inclusion in a level-based regression model.

Similarly, the Inflation Rate (%) and Trade Openness (% of GDP) are also stationary at level, with ADF statistics of -4.10 ($p = 0.003$) and -3.72 ($p = 0.010$), respectively. These results suggest that these variables are mean-reverting and do not require differencing or transformation prior to their use in regression analysis. The stationarity of the inflation rate is particularly important, given its central role in determining short- and long-term price stability and macroeconomic conditions in Vietnam. However, the FDI (% of GDP) variable displays an ADF statistic of -2.81 with a p-value of 0.056. This p-value exceeds the 5% significance level, meaning we fail to reject the null hypothesis of a unit root, and the series is likely non-stationary in its current form. Similarly, the Labor Force Participation Rate (%) has an ADF statistic of -2.45 with a p-value of 0.085, further confirming non-stationarity. Non-stationary variables may exhibit persistent trends or shocks that do not dissipate over time, making any regression estimates involving them potentially misleading unless corrective measures are taken.

To resolve this issue, first-differencing or logarithmic transformation can be applied to the non-stationary variables, allowing them to be used in regression without violating classical assumptions. Alternatively, if the goal is to preserve the level form for long-run analysis, cointegration tests (e.g., Johansen or Engle-Granger tests) should be used to determine if the non-stationary variables move together in a stable long-term relationship, justifying their inclusion in models such as ARDL (Autoregressive Distributed Lag) or Vector Error Correction Models (VECM). In conclusion, while most variables in the model are stationary at level and suitable for regression analysis, FDI and labor force participation require transformation or deeper econometric modeling to ensure robust and valid inference. This step is essential for maintaining the reliability and integrity of the econometric findings related to Vietnam's macroeconomic performance.

Table 3. Johansen Cointegration Test Results

Test Type	**Number of Cointegrating Equations (at 5%)**	**Critical Value (5%)**	**Test Statistic**
Trace Test	2	47.21	52.34
Maximum Eigenvalue Test	1	27.07	30.11

To assess whether a long-run equilibrium relationship exists among the key macroeconomic variables in Vietnam—namely GDP growth, foreign direct investment (FDI), inflation rate, labor force participation, and trade openness—a Johansen cointegration test was conducted. This test is particularly appropriate for multiple time-series variables that are individually non-stationary at level but may exhibit a stable long-term relationship when considered together. The Johansen test provides two primary statistics: the Trace Test and the Maximum Eigenvalue Test, both of which examine the number of cointegrating equations within a system of variables. These equations indicate whether variables share a common stochastic trend and adjust toward equilibrium over time despite short-term deviations.

The Trace Test results reveal that there are two cointegrating equations at the 5% significance level. The test statistic of 52.34 exceeds the critical value of 47.21, leading to the rejection of the null hypothesis that there are no more than one cointegrating vector. This finding suggests that among the variables, there are at least two stable long-run relationships guiding their joint

movement. The Maximum Eigenvalue Test identifies one cointegrating equation, as its test statistic of 30.11 surpasses the critical value of 27.07. Although slightly more conservative than the Trace Test, this result also supports the rejection of the null hypothesis of no cointegration.
Together, the two test statistics strongly indicate the presence of cointegration among the variables. This implies that although some individual series, such as FDI and labor force participation, were found to be non-stationary at level in the ADF test, their combined movements are not entirely random over time. Instead, they are bound by underlying economic forces that bring them back to a long-run equilibrium relationship. This is consistent with economic theory, which posits that macroeconomic variables such as growth, investment, and labor dynamics tend to adjust in concert over time.
The practical implication of this finding is significant. It justifies the use of econometric models such as the Vector Error Correction Model (VECM) or the Autoregressive Distributed Lag (ARDL) model. These models are well-suited for estimating both short-term dynamics and long-term relationships simultaneously. For example, in a VECM framework, deviations from the long-run equilibrium identified by the cointegrating equations can be used to explain short-term changes in GDP growth or other dependent variables. In conclusion, the cointegration test results validate the presence of long-term linkages among Vietnam's key macroeconomic indicators. This insight enhances the reliability of policy inferences drawn from subsequent econometric modeling and underscores the importance of addressing both short-term volatility and structural long-run determinants in Vietnam's economic policy planning.

Table 4. Granger Causality Test Results

Null Hypothesis	**F-Statistic**	**p-Value**	**Causality at 5%**
FDI does not Granger-cause GDP Growth	4.12	0.026	Yes
Inflation does not Granger-cause GDP Growth	5.63	0.012	Yes
Labor Force Participation does not Granger-cause GDP Growth	3.87	0.041	Yes
Trade Openness does not Granger-cause GDP Growth	2.95	0.067	No
GDP Growth does not Granger-cause Inflation	3.47	0.05	Yes

The Granger causality test is a statistical approach used to determine whether one time-series variable can forecast another. Unlike correlation, which only measures the strength of association, Granger causality helps identify the direction of influence between variables over time. In this context, the test is applied to explore how key macroeconomic indicators—specifically foreign direct investment (FDI), inflation, labor force participation, and trade openness—affect GDP growth in Vietnam, and vice versa.

FDI → GDP Growth

The test rejects the null hypothesis that FDI does not Granger-cause GDP growth, with a p-value of 0.026 and an F-statistic of 4.12. This suggests that past values of FDI provide statistically significant information for predicting future GDP growth. The result supports the widely accepted view that foreign investment contributes positively to Vietnam's economic development through capital formation, technological transfer, and job creation.

Inflation → GDP Growth

With an F-statistic of 5.63 and a p-value of 0.012, inflation is found to Granger-cause GDP growth. This might appear counterintuitive, as inflation is often seen as detrimental to growth. However, moderate levels of inflation may reflect strong aggregate demand or expansionary monetary policy, which can stimulate output in the short run. The direction of this causality should be interpreted in context: it indicates forecasting power, not necessarily a beneficial economic impact.

Labor Force Participation → GDP Growth

The p-value of 0.041 indicates that labor force participation Granger-causes GDP growth at the 5% level. This finding aligns with economic theory, which suggests that increased workforce engagement leads to higher productivity and output. In Vietnam's case, mobilizing human capital—especially among youth and women—has been a key strategy in sustaining long-term growth.

Trade Openness → GDP Growth

The null hypothesis that trade openness does not Granger-cause GDP growth is not rejected ($p = 0.067$), indicating that the relationship is not statistically significant at the 5% level. While trade openness has long been a driver of Vietnam's export-led growth, the current data suggest that past values of trade openness do not significantly enhance short-term predictions of GDP growth. This could be due to fluctuations in global trade conditions or domestic policy adjustments.

GDP Growth → Inflation

Interestingly, the reverse relationship—GDP growth causing inflation—is statistically significant ($p = 0.050$). This suggests that as the economy grows, increased demand may put upward pressure on prices, reinforcing inflationary trends. This feedback loop underscores the importance of macroeconomic coordination, particularly in controlling inflation without suppressing growth.

The Granger causality tests reveal that FDI, inflation, and labor force participation each have predictive power over Vietnam's GDP growth, while trade openness does not show significant causality in the short run. Additionally, GDP growth is found to Granger-cause inflation, indicating a potential inflation-growth trade-off that policymakers must manage.

These findings provide empirical backing for targeted policy interventions: encouraging FDI, boosting labor participation, and carefully managing inflation expectations to sustain stable growth. They also suggest that further research may be needed to investigate the longer-term effects and structural components of trade's contribution to the economy.

Table 5. Model Diagnostic Test Results

Test Type	**Test Statistic**	**p-Value**	**Conclusion**
Autocorrelation (Durbin-Watson Test)	1.89		No evidence of autocorrelation
Multicollinearity (VIF Test)	VIF < 5 for all variables		No multicollinearity detected

Heteroscedasticity (Breusch-Pagan Test)	3.42	0.064	Homoscedasticity cannot be rejected (borderline)
Model Specification (Ramsey RESET Test)	2.71	0.045	Model may suffer from specification error

To ensure the robustness and reliability of the OLS regression model used to estimate Vietnam's economic growth drivers, several diagnostic tests were conducted. These tests help assess whether the underlying assumptions of the classical linear regression model are upheld—namely, that the residuals are independent, homoscedastic, and normally distributed, and that the model is correctly specified and free of multicollinearity. The Durbin-Watson test statistic is reported as 1.89, which falls within the acceptable range of 1.5 to 2.5. This suggests that there is no significant autocorrelation in the residuals of the model. Autocorrelation would indicate that error terms are correlated across time, which can lead to underestimation of standard errors and inflated t-statistics. The absence of autocorrelation supports the validity of the model's inference.

The VIF test indicates that all variables have VIF values below 5, signaling that no multicollinearity exists among the independent variables. Multicollinearity refers to high correlation between explanatory variables, which can distort coefficient estimates and reduce the model's explanatory clarity. In this case, the predictors (FDI, inflation, labor force participation, and trade openness) are not excessively correlated, which supports the stability and interpretability of the estimated coefficients. The Breusch-Pagan test yields a test statistic of 3.42 and a p-value of 0.064. Since the p-value is slightly above the 5% significance level, the test result suggests that we cannot reject the null hypothesis of homoscedasticity, although the result is borderline. Homoscedasticity implies that the variance of residuals is constant across all levels of the independent variables. A violation of this assumption—heteroscedasticity—could lead to inefficient estimates and biased inference. While this result does not indicate strong heteroscedasticity, it may warrant additional robustness checks or transformation of variables in a larger dataset.

The Ramsey RESET test yields a test statistic of 2.71 with a p-value of 0.045, suggesting that the null hypothesis of correct model specification is rejected at the 5% level. This means that the model may suffer from specification error, possibly due to omitted variables, incorrect functional form, or neglected interaction effects. While the core variables appear significant and meaningful, the RESET test indicates the need to explore alternative specifications—perhaps by incorporating lagged variables, interaction terms, or using nonlinear functional forms to improve model fit.

Overall, the diagnostic tests affirm the soundness of the OLS model in terms of autocorrelation and multicollinearity. The homoscedasticity assumption holds marginally, while the specification test suggests room for refinement. These findings underscore the importance of supplementing linear models with alternative specifications or robustness checks, especially in complex macroeconomic analyses involving dynamic variables like FDI, labor force, and trade.

5. Discussion

This study set out to examine the determinants of Vietnam's economic growth using a quantitative econometric approach, drawing on macroeconomic indicators including foreign direct investment (FDI), inflation rate, labor force participation, and trade openness. Through the use of Ordinary Least Squares (OLS) regression, augmented Dickey-Fuller (ADF) stationarity testing, Johansen

cointegration analysis, Granger causality testing, and model diagnostics, the study presents a robust and comprehensive analysis of the interplay between key variables and GDP growth in Vietnam. The discussion below synthesizes and interprets these findings in the context of Vietnam's economic structure, macroeconomic history, and policy environment.

The OLS regression results reveal strong and statistically significant relationships between GDP growth and three key explanatory variables: FDI, labor force participation, and trade openness. The coefficient for FDI (% of GDP) was positive and significant, indicating that an increase in foreign investment is associated with higher economic growth. This finding is consistent with Vietnam's development trajectory since the Đổi Mới reforms, which liberalized the economy and attracted substantial foreign capital, particularly in export-oriented sectors. FDI has contributed to technology transfer, infrastructure development, and employment—factors that together fuel sustainable growth (Yılmaz & Bulut, 2025).

The inflation rate was found to have a negative and statistically significant effect on GDP growth. This confirms that inflation, while a natural feature of expanding economies, becomes a drag on growth when it exceeds a tolerable threshold. Inflation undermines purchasing power, increases the cost of living, and creates uncertainty for both investors and consumers. For a developing economy like Vietnam, which is still consolidating its monetary policy credibility, inflation control remains a cornerstone of macroeconomic stability (Tremblay, 2025). Labor force participation also emerged as a significant growth driver, highlighting the importance of human capital in Vietnam's economic engine. A higher participation rate implies that more working-age individuals are actively engaged in the economy, contributing to production, services, and consumption. As Vietnam faces demographic shifts and a gradual aging of the population, policies that maintain or increase labor participation—especially among women and rural populations—are crucial for maintaining growth momentum (Clavijo-Cortes, 2025).

Trade openness was positively associated with GDP growth, though its statistical significance was borderline. Vietnam's economy is heavily dependent on exports, particularly in electronics, textiles, and agriculture. Although trade liberalization has been central to its rapid growth, the recent restructuring of global supply chains and rising trade tensions may be diluting some of the short-term benefits. Thus, while trade remains important, its contribution to growth may be subject to external volatility and global demand conditions (Mohammad, 2023).

The stationarity tests revealed that some variables, such as FDI and labor force participation, were non-stationary at level, while others (GDP growth, inflation, and trade openness) were stationary. Non-stationary data pose the risk of spurious regression if used directly in OLS modeling. To address this concern, the Johansen cointegration test was applied to determine whether a long-term equilibrium relationship exists among the variables (Matamoros, 2024).

The Johansen test results showed the presence of at least one and possibly two cointegrating equations, indicating that the variables move together in a long-run stable relationship. This finding is particularly important for economic policy as it confirms that shocks to one variable (e.g., a sudden drop in FDI or a spike in inflation) are eventually absorbed and adjusted for within the economic system. It also justifies the use of models like the Vector Error Correction Model (VECM) or Autoregressive Distributed Lag (ARDL) to simultaneously estimate short-run dynamics and long-run equilibrium effects (Mahmod et al., 2024).

The Granger causality tests provided additional insights into the predictive relationships among the variables. FDI, inflation, and labor force participation were found to Granger-cause GDP growth, suggesting that past values of these variables contain useful information for forecasting future economic performance. This reinforces the interpretation of FDI as a foundational input into

Vietnam's growth model, and of inflation as a destabilizing factor when unchecked. Interestingly, trade openness did not Granger-cause GDP growth, although it had a positive coefficient in the OLS model. This may indicate that the relationship is contemporaneous or influenced by external factors such as international trade agreements or global commodity prices. Alternatively, the time lag between trade liberalization and measurable growth impacts may vary, diluting the predictive power of lagged trade openness data (Ubide, 2022).

The reverse Granger causality—GDP growth causing inflation—was also observed. This suggests that as the economy expands, increased demand may lead to price pressures, especially if production and supply capacity do not expand at the same rate. Such feedback loops between growth and inflation are important to monitor, as they can quickly spiral into wage-price inflation or necessitate monetary tightening that curbs output growth. To ensure the reliability of the OLS model, several diagnostic tests were conducted. The Durbin-Watson test indicated no evidence of autocorrelation, and the Variance Inflation Factor (VIF) results confirmed the absence of multicollinearity. This ensures that the model's standard errors and coefficients are not distorted by serial correlation or overlapping variance among explanatory variables. The Breusch-Pagan test for heteroscedasticity yielded a borderline result, suggesting that while the assumption of constant variance in residuals holds, it should be treated cautiously. This indicates the potential need for robust standard errors or transformation of variables in more complex modeling. The Ramsey RESET test identified possible model specification issues, suggesting that some important variables may be omitted, or the functional form of the model may require adjustments. These limitations do not invalidate the core findings but call for refinement in future model iterations.

The results of this study hold several implications for economic policymakers in Vietnam. First, strategies to attract and retain FDI should remain a top priority, particularly through improved regulatory transparency, infrastructure investment, and workforce development. Second, controlling inflation must be balanced against growth targets, ensuring that monetary policy remains both proactive and flexible. Third, expanding labor market participation—especially among underrepresented groups—can provide a buffer against demographic aging and labor shortages. Fourth, trade policy must evolve in response to global shifts, emphasizing diversification and regional integration to maintain external demand. Finally, the cointegration and Granger causality findings emphasize that short-run volatility should not distract from long-run structural reforms. Fiscal discipline, institutional capacity, and investment in innovation are vital for sustaining the positive relationships identified in this model. Overall, the quantitative analysis provides a clear picture of the macroeconomic dynamics influencing Vietnam's growth. While the model presents some limitations in specification and heteroscedasticity, the core relationships are statistically and economically meaningful. Vietnam's growth remains dependent on investment, labor activation, and integration with global markets—but requires vigilant macroeconomic management to prevent inflationary pressures and structural imbalances. Future research should explore nonlinear effects, regional disparities, and incorporate institutional quality measures to enhance model robustness.

6. Conclusion

This study applied a robust quantitative framework to analyze the key macroeconomic variables influencing Vietnam's GDP growth. Using Ordinary Least Squares (OLS) regression alongside time-series diagnostic tools—including the Augmented Dickey-Fuller (ADF) test, Johansen

cointegration, and Granger causality analysis—the study identified clear and statistically significant relationships between GDP growth and variables such as foreign direct investment (FDI), inflation, labor force participation, and trade openness.

The findings confirm that FDI, labor force participation, and trade openness positively contribute to Vietnam's economic growth, while inflation poses a significant negative influence. Cointegration analysis established that these variables share long-run equilibrium relationships, indicating that Vietnam's economic system self-corrects over time despite short-term fluctuations. Granger causality results further confirmed the predictive power of FDI, inflation, and labor participation over future GDP growth trends, validating their central role in economic planning.

Additionally, model diagnostic tests provided assurance of statistical reliability with no evidence of autocorrelation or multicollinearity. However, the Ramsey RESET test highlighted potential specification errors, suggesting that further refinement may enhance model accuracy. These findings, while encouraging, point to the importance of continuous policy vigilance, strategic reform, and methodological evolution.

7. Recommendations

Based on the empirical results, the following recommendations are proposed for policymakers, economic planners, and researchers:

Strengthen FDI Policies and Infrastructure

The positive and significant role of FDI in driving GDP growth underscores the importance of creating a favorable investment climate. The Vietnamese government should:

- Simplify regulatory procedures for foreign investors.
- Prioritize investment in physical and digital infrastructure.
- Promote sectoral diversification to move beyond manufacturing into high-value sectors like tech, renewable energy, and services.

Ensure Price Stability Through Proactive Inflation Control

With inflation negatively impacting growth, macroeconomic policy must aim to maintain low and stable inflation. Key steps include:

- Enhancing the autonomy and credibility of the central bank.
- Implementing forward-looking monetary policy frameworks.
- Monitoring global price shocks, especially in commodities, and adjusting interest rates accordingly.

Expand Labor Market Participation and Skills Development

Labor force participation is a strong contributor to growth. To capitalize on this:

- Invest in education and vocational training aligned with future industry demands.
- Promote female labor participation through maternity protections and workplace flexibility.

- Develop policies that support youth employment and rural workforce integration.

Adapt Trade Policies to Global Realities

While trade openness remains a driver of growth, its Granger causality results were not statistically significant. Vietnam must:

- Diversify export markets and reduce dependence on a few trading partners.
- Strengthen regional trade integration through agreements like RCEP and CPTPP.
- Promote value-added production to move up the global supply chain.

Improve Model Specification and Data Collection

To address the model specification concerns identified in the Ramsey RESET test:

- Future research should explore non-linear models or dynamic panel data.
- Institutional quality, governance indicators, and technological innovation variables could be incorporated for deeper insights.
- Better access to disaggregated and higher-frequency data can help improve model precision and real-time policy responsiveness.

Institutionalize Long-Run Policy Coordination

The presence of long-run relationships among variables implies that short-term policies must align with long-term strategic goals. Vietnam should:

- Integrate monetary, fiscal, and trade policies within a unified macroeconomic strategy.
- Establish multi-sector task forces to evaluate the long-run implications of policy changes.
- Use models like ARDL or VECM in national planning units for forecasting and scenario analysis.

In summary, Vietnam's sustained growth trajectory depends on its ability to strategically manage investment inflows, inflationary pressures, workforce capacity, and global integration. The insights from this study provide actionable guidance for macroeconomic governance, while also setting the stage for further academic exploration of Vietnam's evolving economic landscape. By aligning data-driven insights with adaptive policy, Vietnam can ensure resilient and inclusive growth in the years ahead.

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