Asia
Economics & Strategy

HSBC
Global Research

Vietnam Monitor (Issue 21)

Growth to slow further, inflation to collapse in 2009

- **Economics**: Growth to weaken to 10-year low of 5.4% in 2009 but then recover on the back of lagged impact of rate cuts and large fiscal stimulus. Inflation to collapse to 5% by mid-2009 and then gradually rise to long-term average of 11% by end-2010. Central bank to cuts rates by another 100bps in Q1 to 7.5%, which we think will be the bottom of the cycle.

- **Equity Strategy**: Vietnam was the worst market in Asia in 2009, falling 69%. With no stocks over USD1bn, it has become uninvestible for mainstream foreign investors. Keys for 2009: restarting privatisations and more transparent earnings.

- **Fixed Income Strategy**: Balance of risks favour rebuilding positions in VGBs as positive bond fundamentals to continue, though potential further downside unlikely to be as brisk as in recent month. Higher VGB supply is likely to be absorbed by the market.

- **FX Strategy**: The authorities set the USD-VND midpoint 3% higher on 25 December. Better exchange rate regime management should keep the currency market more orderly and functional. However, continued gradual trend depreciation is still in order.

7 January 2009

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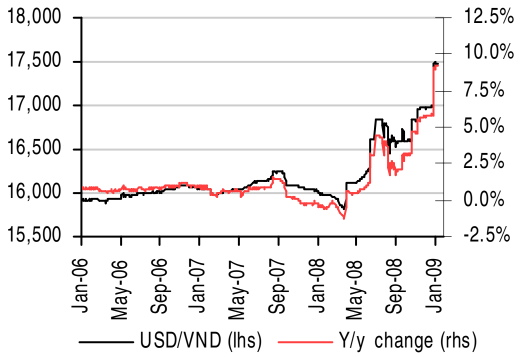
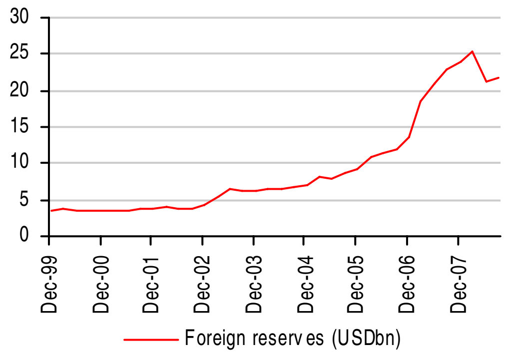
USD/VND



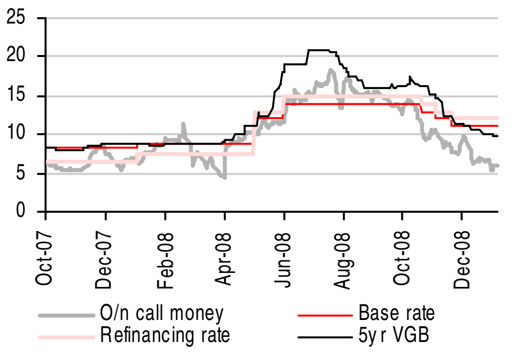
Source: Bloomberg

FX reserves



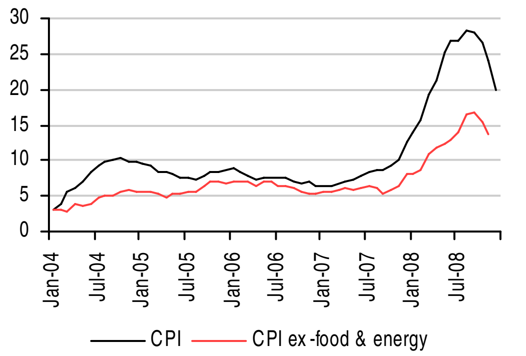
Source: CEIC, *HSBC estimate for 1Q08

O/n call money, benchmark policy rates and 5yr bond yields



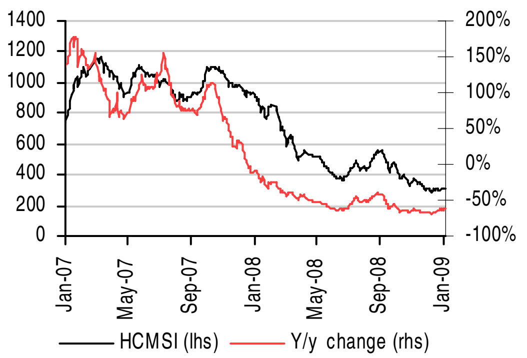
Source: Reuters, HSBC

Headline CPI and ex-food & energy



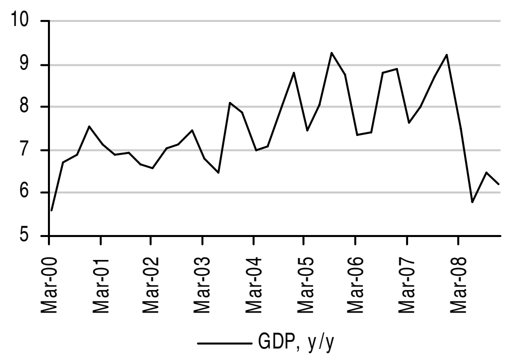
Source: CEIC, HSBC

HCMS Index



Source: Bloomberg

GDP growth



Source: CEIC

HSBC

Economics

- Growth to weaken to 10-year low of 5.4% in 2009 but then recover on the back of lagged impact of rate cuts and large fiscal stimulus
- Inflation to collapse to 5% by mid-2009 and then gradually rise to long-term average of 11% by end-2010
- Central bank to cuts rates by another 100bps in Q1 to 7.5%, which we think will be the bottom of the cycle

Overview

The year 2008 was very challenging for Vietnam, having flirted with a balance of payment crisis and runaway inflation. However, 2009 brings with it new challenges and also opportunities. In the first edition for the year, we thought it best to lay out our main macro calls for Vietnam.

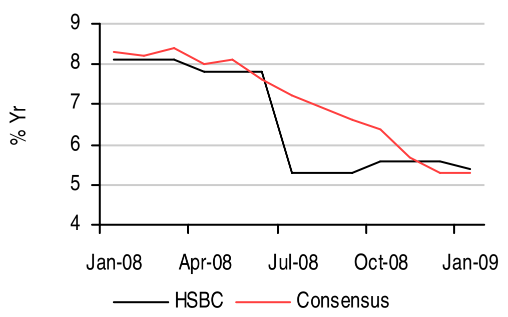
But before we get into the details, we think it is fair to highlight that Vietnam has indeed come a long way. GDP per capita is slated to surpass USD1000 in 2009, a year ahead of the government's target, compared with USD400 in 2000.

Our main macro calls:

(1) Growth to slow further

Vietnam grew by 6.2% year-on-year in 2008 – the worst performance since the 4.8% print in 1999. For 2009, we look for the economic momentum to slow further, with GDP growth printing at 5.4%, a view which we have held for sometime now. This compares with the government's target of 6.5%.

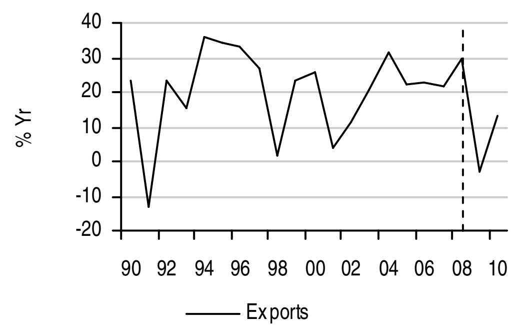
1. Consensus catching up to our 2009 GDP forecast



Source: HSBC, Asia Pacific Consensus Forecast

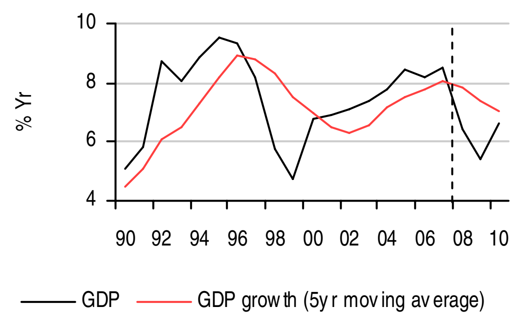
So what is the cause for our pessimism? For one thing, exports, which make up roughly 70% of the economy, are expected to crumble given the synchronised recession in the developed world, which accounts for 55% of Vietnam's exports. At the same time, softer growth in Asia will dent intra-regional trade. As such, we look for exports to contract by 3% – the worst performance since 1991 – compared with a near 30% expansion in 2008.

2. Exports to crumble in 2009



Source: CEIC, HSBC

3. The fall before the rise



Source: CEIC, HSBC

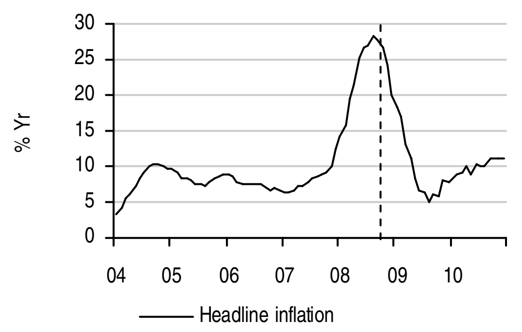
The trouble is that it's not just exports that will slow, but domestic demand is expected to take a breather as well, largely on account of lower investment. A part of this is a spill over from the export weakness, but at the same time foreign direct investment, which makes up 20-25% of total investment, is likely to fall to around USD5bn in 2009 from a very robust USD11bn in 2008. The rationale for this unusual turnaround being that the financial crisis is going to make it that much more difficult for firms to fund investment and expansion whilst at the same time – in an environment of deteriorating growth outlook – firms are bound to be more cautious.

All however is not lost, as we believe that the lagged impact of the policy stimulus (see below) together with a gradually improving external demand environment[1] will allow growth to bounce back in 2010, with our forecast being 6.6%. This gives us a V-shaped recovery, similar to what was seen following the Asian financial crisis.

(2) Inflation to collapse

On the inflation front, just as CPI went up dramatically in 2008, it is going to fall with as much vengeance in 2009 as high commodity prices drop out of the comparison. In addition, weaker growth should help contain underlying price pressures in the economy. As such, we think inflation is slated to hit a low of 5% by the middle of 2009 and then start heading up gradually, reaching its long-term average of 11% by the end of 2010. For 2009, as a whole, we expect inflation to average 9.5% compared with 23% in 2008.

4. Inflation to collapse



Source: CEIC, HSBC

The decline in inflation will no doubt boost real disposable incomes in the country, thereby supporting consumer spending. However, it is fair to highlight that in an uncertain economic environment, the extra cash will probably go more towards saving rather than increased spending,

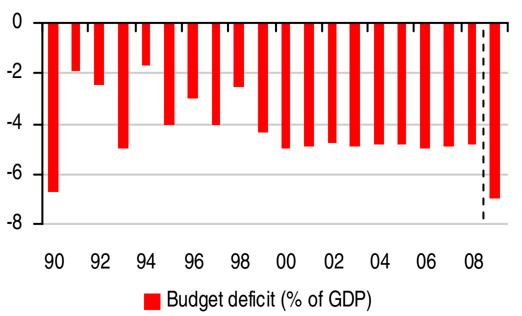
[1] See *Lost…and not yet found*, HSBC Global Economics Outlook Q1 2009 for further details.

thus keeping a lid on domestic private consumption growth.

(3) Budget deficit to widen

The government, in an attempt to meet its 6.5% growth target for 2009, has announced new spending plans to the tune of USD6bn (6% of GDP), in infrastructure and export-oriented sectors, with the objective of generating more employment. Although the details have not yet been stated, media reports indicate that roughly USD1bn will be given to the Ministry of Planning and Investment to boost investment in the country. It remains to be seen whether the plans will materialise in full though. Based on the experience of other countries in the region, such as Indonesia, Malaysia etc, we are doubtful. Nevertheless, increased spending, even if it's not of the magnitude the government has predicted, and lower revenue collections on the back of weaker growth, will see the budget deficit widen. Our forecast is for a shortfall of 7% of GDP, compared with 5% in 2008.

5. Budget deficit to hit a historical high



Source: CEIC, HSBC

The other point worth highlighting is that the fiscal boost, if it materialises, is large and, as stated by the IMF in the conclusion to its 2008 Article IV consultation, may result in an undesirable weakening of the external position in the absence of additional external financing.

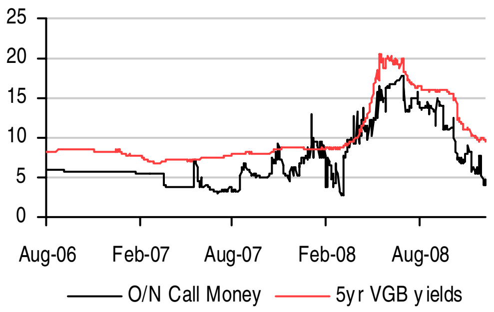
(4) Central bank nearly done

The central bank has been doing its bit to support growth, having slashed the base interest rate by 550bps to 8.5% over a two-month period ending December, unwinding all but 25bps of the tightening that was delivered in the first half of 2008. With the base rate at 8.5%, the cap on the lending rate stands at 12.75% (1.5 times the base rate). Given the aggressiveness of the move, we think the bulk of the easing has now been delivered by the central bank. However, we do believe that the bank will, as an insurance policy, cut rates by a further 100bps in the first quarter of 2009, with rates bottoming at 7.5%. After that, we think rates will hold steady right through the year and into 2010.

Commercial bank lending rates are coming down in line with the policy rate cuts, although the question remains whether firms will be willing to get additional loans, especially when few new orders are coming their way. Additionally, banks are likely to be prudent in an environment of slowing economic growth and rising non-performing loans, and so may prefer to lock their funds in government bonds rather than expanding their balance sheets.

The central bank has also taken aggressive action to boost liquidity in the domestic banking system by slashing the reserve requirement ratio by 600bps to 5% and agreeing to buy back VND20.3trn of compulsory Treasury bills sold to commercial banks in March last year. The central bank may be inclined to do a bit more, but if overnight rates are used as an indicator then liquidity is already clearly ample in the local market.

6. Overnight interest rates and yields have come off



Source: Bloomberg, HSBC

8. Imports and exports to collapse

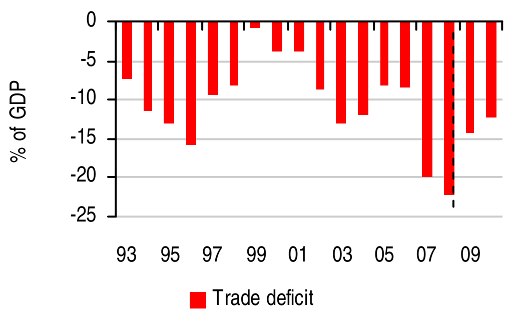
Source: CEIC, HSBC

(5) Trade deficit to shrink

As we mentioned in the growth section, exports have turned sharply and will continue to weaken into 2009 given the collapse in demand from the developed world and also softer growth in Asia. To re-iterate, we expect exports to contract by 3% over 2009, down from a 30% expansion in 2008. On the import side of the equation, we think the fall will be even greater, on the back of the collapse in commodity prices, weaker demand for intermediate goods (inputs for exports) and softer domestic demand. As such, we are pencilling in an 8% contraction in imports compared with a 30% expansion in 2008.

Overall then, we expect the trade deficit to improve in 2009, declining to around 14% of GDP from 22% of GDP in 2008. Assuming FDI inflows of USD5bn and remittances of a similar amount, this sees the current account deficit to improve by 3ppts to 10.5% of GDP.

9. Trade deficit to shrink



Source: CEIC, HSBC

Prakriti Sofat

HSBC

Equity strategy

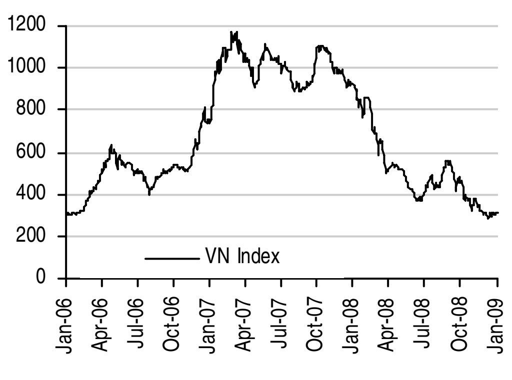
- Vietnam was the worst market in Asia in 2009, falling 69%
- With no stocks over USD1bn, it has become uninvestible for mainstream foreign investors
- Keys for 2009: restarting privatisations and more transparent earnings

Becoming investible

What would make 2009 better?

The Vietnamese market is becoming increasingly marginalised. In 2008, the VN Index was down 69% in US dollar terms, the worst performance of any Asian market. MSCI Asia ex Japan, by comparison, fell 53%. Neither did Vietnam share in the rebound in equity markets in the last six weeks of the year: while Asian equities rose 23% from 20 November to the end of the year, Vietnam actually fell by 3%.

1. Vietnam stock index

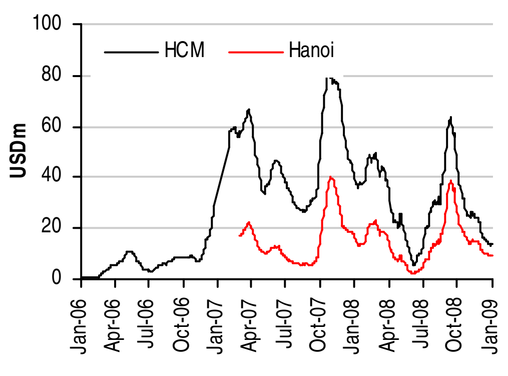


Source: Bloomberg

What is worse, the Vietnamese stock market has become virtually uninvestible for mainstream international investment institutions. There is not a single stock foreigners can buy that has a market cap over USD1bn (and there are only five stocks with a market cap of USD500m or more and reasonable room for foreigners to buy that might qualify for small-cap funds) – see Table 7 for details.

Moreover, turnover on the stock market (Chart 2) has almost dried up again, with the Hanoi Stock Exchange (the only one of the two Vietnamese bourses that most foreigners are happy to trade on) seeing turnover of only USD14m a day on average during December.

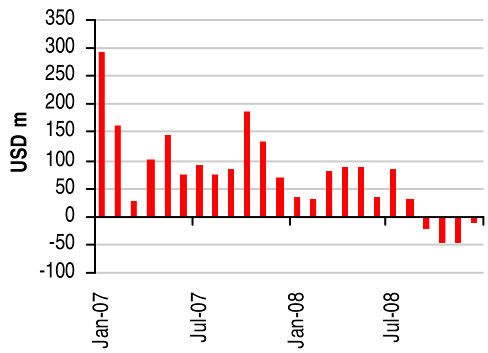
2. Daily trading value on HCM and Hanoi exchanges (20DMA)



Source: Bloomberg

In this environment, foreign enthusiasm for the Vietnam market has almost completely evaporated over the past few months. Foreigners have been net sellers consistently since September (see Chart 3) and have sold a total of USD127m net over that time. The selling slowed in December but perhaps only because most foreign investors, except for specialist Vietnam country funds, have now sold out. The market's largest IPO in the past 12 months, by Vietinbank on 25 December, was fully subscribed (just) but only three foreign institutions bid for shares.

3. Foreign net buying of Vietnamese equities



Source: Bloomberg (To Nov 23)

With this backdrop, in our latest *Asia Insights Quarterly*, we dropped to zero our small non-benchmark recommended weighting in Vietnam. We take the view that, even when risk appetite does come back to global markets, there are other markets in Asia that look more attractive as a first entry-point. Vietnamese companies' earnings are highly non-transparent, and massive macro policy errors last year have put the long-term attractiveness of the market in doubt. Furthermore, Vietnam's high dependence on FDI flows and exports means that 2009 growth is under significant pressure. Vietnam's entrepreneurial spirit and appealing demographics will make this market interesting again one day, but not for the next few quarters.

How to make 2009 better

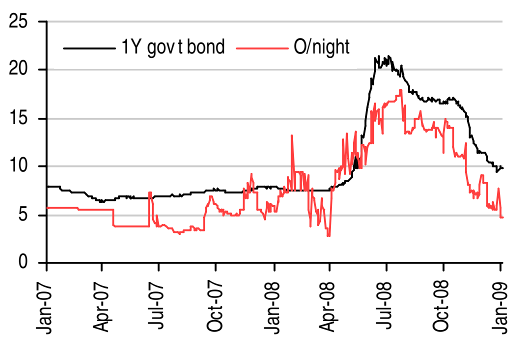
What are the factors that will decide whether Vietnam has a more successful year in 2009?

- **Company earnings**. A major problem with Vietnam is that listed companies' earnings are highly non-transparent. That is partly because of a lack of consensus forecasts (very few analysts cover the companies), but also because only annual results are audited, and because extraordinary write-offs are generally taken only at year-end. The coming results season (listed companies have to report by end-January) will give some clarity on how bad real estate and stock market related losses were in 2008, and on the outlook for this year.

- **Privatisations**. Large-scale IPOs were almost non-existent last year after the IPO of Vietcombank in late 2007 (of course, global conditions did not help). We continue to take the view that privatisation of some of the crown jewels of the Vietnamese economy (in particular oil and gas, telecoms and banking), if well structured and sensibly priced, would attract significant foreign interest and get the stock market going again. The mooted IPO of telecoms operator Mobifone in H1 would be the first sign that this is happening.

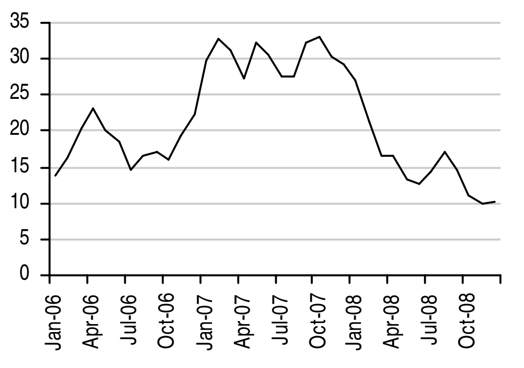
- **Interest rates** come down significantly further. Despite sharp cuts in official interest rates (by 250bps in December alone), market rates remain high – and, indeed, government officials still talk frequently about the continuing risk of inflation. Overnight inter-bank rates are 5% and 10-year government bonds 10% (see Chart 4). This makes equities look relatively unattractive to local investors. Moreover, concerns about the currency (which fell 9% against the US dollar in 2008 – and was devalued a further 3% on 25 December) and the lack of dollar liquidity – which makes it difficult to repatriate profit from VND-denominated equities – deter foreign investors too.

4. Overnight and one-year interest rates



Source: Bloomberg

6. Estimated 12-month forward PE for VN Index



Source: HSBC

- **Cheaper valuations**. Despite the collapse of the stock market over the past two years, the Vietnamese market does not look unarguably good value. The PE, based on the last reported earnings (2007) is 9.0x. If we assume that EPS fell 10% last year and will be flat this year (we have lowered this year's growth assumption from the previous +15% to take into account worsened global conditions), that puts it on a 12-month forward PE of 10.1x (Chart 6). In an Asian context, that is only middle-ranking: among Asean markets, for example, Indonesia is on 8.0x and Thailand on 7.2x. Given the lack of transparency on Vietnamese earnings, investors will probably demand rock-bottom valuations before they are willing to re-enter.

5. Key stock market data

	HCM	Hanoi	Total
Market cap (USD m)	9,597	3,311	12,909
No. of stocks	170	168	338
Stocks with mkt cap >USD1bn	0	1	1
Stocks with mkt cap >USD500m	7	1	8
Stocks with mkt cap >USD200m	14	3	17
Stocks that hit foreign limit	3	5	8
Daily turnover (USDm, 1mth ave)	0	0	0
Foreign ownership	23.2%	14.0%	20.9%
PE (2007) x	9.0	10.1	
ROE	22.9%	17.2%	22.8%

Source: HSBC, Bloomberg, HOSE

- A more attractive regime for **local investors**. Part of the explanation for the poor performance in the last few months of 2008 was the pending introduction from 1 January of a dividend and capital gains tax for local individual investors. The fact that the government chose to go ahead with this – and not cancel it to bolster the stock market – gave a very strong signal that the authorities do not consider the health of the market to be a major priority.

All in all, we expect 2009 to be another difficult year – for the region's stock markets as a whole, as well as just Vietnam. We see the Vietnam market being somewhat volatile, with some large up and down swings, but ultimately making little progress. Our target for the VN Index for end-2009 is 300, almost the same as the end-2008 level of 316.

HSBC

7. Key valuation data for the largest listed Vietnamese stocks (market cap >USD200m)

Code	Name	Industry Subgroup	Exchange	Mkt cap (USD mn)	Ave daily t/over (USDm)	Foreign ownership	Foreign limit	Room for foreign buying (USDm)	PE	Chg 3M
ACB	ASIA COMMERCIAL BANK	Commer Banks Non-US	Hanoi	1,010	2.36	30%	30%	0	6.7	-28%
VNM	VIET NAM DAIRY PRODUCTS JSC	Food-Dairy Products	HCM	838	0.85	45%	46%	12.2	14.9	-12%
DPM	PETROVIETNAM FERT & CHEMICAL	Chemicals-Diversified	HCM	750	1.38	18%	49%	235.5	9.9	-42%
HAG	HAGL JSC	Miscellaneous Manufactur	HCM	618	n/a	17%	49%	197.7	n/a	n/a
PVD	PETROVIETNAM DRILLING AND WE	Oil-Field Services	HCM	613	1.02	29%	49%	122.3	18.4	-13%
PVF	PETROVIETNAM FINANCE JSC	Finance-Invest Bnkr/Brkr	HCM	550	n/a	11%	30%	102.5	n/a	n/a
STB	SAIGON THUONG TIN COMMERCIAL	Commer Banks Non-US	HCM	536	2.75	30%	30%	0.0	6.6	-27%
VIC	VINCOM JSC	Real Estate Oper/Develop	HCM	514	0.24	5%	49%	227.3	26.1	-19%
KBC	KINHBAC CITY DEVELOPMENT SHA	Bldg-Residential/Commer	Hanoi	475	0.15	2%	49%	222	25.4	-24%
FPT	FPT CORP	Telecommunication Equip	HCM	403	1.41	27%	49%	87.1	9.3	-21%
VPL	VINPEARL JSC	Resorts/Theme Parks	HCM	361	0.30	16%	49%	118.3	50.7	-43%
PPC	PHA LAI THERMAL POWER JSC	Electric-Generation	HCM	358	0.36	18%	49%	111.4	7.4	-40%
HPG	HOA PHAT GROUP JSC	Miscellaneous Manufactur	HCM	349	1.04	24%	49%	88.8	8.2	-43%
PVS	PETROLEUM TECHNICAL SERVICES	Transport-Services	Hanoi	297	0.99	9%	49%	119	14.1	-14%
SSI	SAIGON SECURITIES INC	Finance-Invest Bnkr/Brkr	HCM	223	1.29	46%	49%	6.5	3.4	-46%
VSH	VINH SON - SONG HINH HYDROPO	Electric-Generation	HCM	223	0.26	28%	49%	46.9	14.3	-11%
ITA	TAN TAO INVESTMENT INDUSTRY	Real Estate Oper/Develop	HCM	201	0.36	33%	49%	33.0	6.9	-45%

Source: HSBC, Bloomberg, HOSE (Data as of Jan 2)

Garry Evans

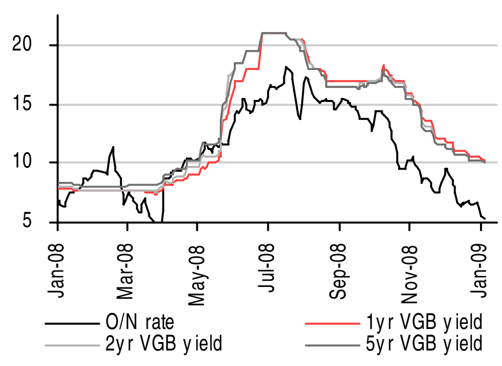
Fixed income strategy

- Balance of risks favour rebuilding positions in VGBs as positive bond fundamentals to continue…
- …though potential further downside unlikely to be as brisk as in recent month
- Higher VGB supply is likely to be absorbed by the market

Rally proved resilient

Last month, we recommended taking profit on Vietnam government bonds (VGBs) as 2yr and 3yr bond yields reached our 12% target. Our recommendation to take profits was motivated by expectations of profit-taking and tightening liquidity over the Vietnamese "Tet" New Year (26-29 January). Since October 2008, VGBs have sustained a 600bp-rally to 10.00% (bid) for 2-5yr VGBs.

1. Bonds advanced in December, O/N rate remained stable



Source: HSBC, Reuters

While some local banks took profit, bond appetite remained strong due to lacklustre demand for corporate sector borrowings. Moreover, while local banks sold bonds to realise profits, they immediately repurchased those bonds – thus allowing a further decline in VGB yields to 9.5% at present (done as banks do not have to mark-to-market bond holdings). Also worth noting, since the one-off VND devalution on 25 December, there was been a flicker of offshore investor demand[2].

Further downside in yields, but more gradual

As we have mentioned in past issues of *Vietnam Monitor*, VGBs have benefited from favourable bond dynamics led by: flush domestic liquidity, aggressive SBV easing and a convincing decline in headline inflation.

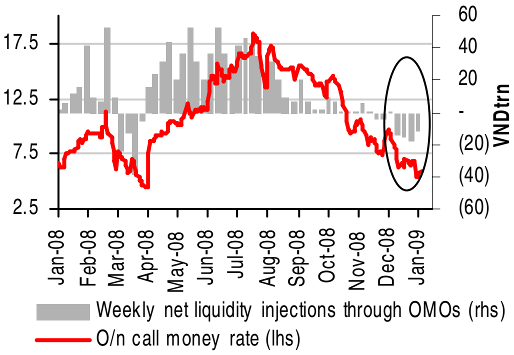
Further downside in yields is underpinned by an expected continuation of positive bond fundamentals.

- First, domestic liquidity is likely to remain flush given slack demand for corporate loans – from both lenders and issuers. This implies a continued decline in the O/N interbank rate. Note that in December 2009, the SBV

[2] *Thanh Nien News* reported that offshore investors purchased VND600bn in local government bonds during the week ending 2 January 2009 ("Foreigners buy bonds as dong falls", 5 January 2009). The repatriation of foreign flows into VGBs and the currently low positioning by offshore investors in the bond market – down to roughly a quarter of the holdings since the peak of USD3.0bn in mid-2008 – is a stabilising factor.

mopped up excess liquidity through open market operations – in relatively large quantum – for the first time in nearly a year (see Figure 2) – suggesting loose monetary conditions at present.

2. Liquidity so flush that SBV reintroduces mopping-up operations



Source: HSBC, Reuters

Moreover, liquidity conditions are likely to remain loose as bank loan-deposit ratios should fall – raising appetite for VGBs – as new loan demand remains low.

- Secondly, there remains broad-based consensus of further SBV easing – given growth imperatives and the anticipated sharp decline in inflation expectations – on top of 550bp in SBV base rate cuts since October 2008. Our economist sees 100bps more in rate cuts as soon as the end of 1Q09, which would bring the base rate to 7.50% (see Economics section). The market, however, appears to be starting to price in 200bp in cuts, which would then reduce the lending rate cap to 9.75%.

- Thirdly, VGBs at current levels are still attractive on yield pick-up basis alone, which are still substantial in comparison to deposit funding costs (8.4% all-in for 3mth-time deposits) and relative to the O/N call rate (currently 5.50%). Furthermore, VGBs at just 100bp below the 10.5% lending rate cap currently would be even more appealing for local banks in the event that the SBV ease rates by 200bp.

3. Vietnam bond yields (mid-yields)

Vietnamese bonds	Tenor	2-Oct-08 Yield	2-Dec-08 Yield	5-Jan-09 Yield
Vietnam government bond	2yr	16.3%	10.00%	9.50%
	5yr	16.0%	9.50%	9.00%
	10yr	15.1%	9.00%	8.50%
Electricity Vietnam	10yr	20.0%	13.00%	12.00%
Development Bank of Vietnam	5yr	17.0%	9.70%	9.20%
	10yr	16.0%	9.20%	8.70%
	15yr	15.5%	9.40%	8.90%
Bank for Investment & Development	10nc5	17.5%	11.50%	11.00%
	15nc10	17.0%	11.00%	10.50%
Vinashin	10yr	20.0%	14.00%	13.00%

Source: HSBC

In our view, a continuation of these positive bond fundamentals well into 1H09 as well as relatively low offshore investor participation should add further tailwind to the VGB rally. We note, however, that a decline in VGB yields, going forward, is unlikely to be as brisk as that witnessed in 4Q08.

In this respect, we now forecast 2yr, 3yr and 5yr VGB yields to decline – with a slight steepening bias – to a more modest 150-200bp to 7.00%, 7.25% and 8.00% (mid), respectively by the end of 1Q09. For the 5yr VGB, we calculate that such a 150bp-decline in the 5yr VGB yield would gain a total return of approximately 13.5% over a 12mth-holding period (ex-transaction costs), which should be sufficient to offset a potential further weakening in the VND.

4. Summary of recent monetary action

	22 Dec-08	5 Dec-08	21 Nov-08	3 Nov-08	20 Oct-08	1 Oct-08
Base rate	8.5%	10.0%	11.0%	12.0%	13.0%	14.0%
Discount rate	7.5%	9.0%	10.0%	11.0%	12.0%	13.0%
Refinancing rate	9.5%	11.0%	12.0%	13.0%	14.0%	15.0%
Lending rate ceiling	12.8%	15.0%	16.5%	18.0%	19.5%	21.0%
Reserve requirement						
- VND, non-term	5.0%	6.0%	8.0%	10.0%	11.0%	11.0%
- VND, >12mths	1.0%	2.0%	2.0%	4.0%	5.0%	5.0%
- FC, non-term	7.0%	7.0%	9.0%	11.0%	11.0%	11.0%
- FC, >12mths	3.0%	3.0%	3.0%	3.0%	5.0%	5.0%
Interest on VND reserve deposits	8.5%	9.0%	10.0%	10.0%	10.0%	5.0%

Source: HSBC

Does VGB supply matter?

Late last month, the government announced plans for a fiscal stimulus, which it says will be financed with an additional VND36trn in VGB supply. The total package, PM Dung announced, could ultimately reach as high as USD6.0bn. The first tranche – valued at VND17.0trn – will be deployed to subsidise commercial loans by smaller enterprises.

At first glance, there may be reasons to be concerned with the potential sharp increase in VGB supply. Even before the stimulus plan was announced, the 2009 budget plan already programmed VND43trn in net issuance – an 87%-increase in net domestic issuance from VND23trn last year.

5. 2009 budget plan envisages large financing needs

VNDtr	2008 (provisional)	2009 (planned)	Y-o-y change
GDP	1,490.0	1,813.0	22%
Total revenues	399.0	389.9	-2%
Total expenditures (ex-principal payments)	439.4	456.6	4%
Principal payments	34.9	34.7	-1%
Total financing (net)	**31.3**	**52.6**	**68%**
Of which:			
Domestic (net)	23.0	**43.0**	**87%**
- Issued	51.2	**71.3**	**39%**
- Repayed	28.2	28.3	0%
External (net)	8.3	9.5	15%
- Issued	15.0	16.0	7%
- Repayed	6.7	6.5	-3%
Overall deficit (gross issuance)	**(66.2)**	**(87.3)**	**32%**
- Deficit/GDP (%)	5.0%	4.8%	-

Source: Ministry of Finance

However, supply risk should not be overplayed. First, at least under current conditions, new supply will likely be absorbed by declining bank loan-deposit ratios as well (as other positive bond fundamentals discussed in the previous section) barring a resumption in loan demand.

Second, we highlight that the government may stop short of fulfilling its issuance plan if doing so would present a threat to other economic considerations. Recall that the government, in the first nine months of the year, issued just one-quarter (VND12trn, or roughly USD0.75bn) of its budgeted bond issuance in an effort to cool growth and curb a yawning trade deficit. In this respect, the IMF has cautioned, after its Article IV mission last month, that the government's USD6.0bn-stimulus program may re-expose the economy to external vulnerabilities[3].

In this regard, allocations at upcoming VGB auctions will serve as a useful barometer for government commitment to such an ambitious fiscal stimulus package. Note that while government bond issuance has substantially improved in 4Q08, recent bond auction failures indicated that SBV target yields for VGB auctions are still too aggressive – offsetting the large number of participating bids.

Virgil Esguerra / Pieter van der Schaft

[3] "Government plans for a large stimulus package – reportedly up to USD6bn – may result in an undesirable weakening of the external position in the absence of additional external financing"

6. Auction results need to improve to gauge commitment to stimulus

Date	Planned size	Tenor	Type	Target yield	Result (issue size, VNDtrn)	
24-Oct-08	300	3Y	VDB	15.00%	Size issued	40
	300	5Y	VDB	15.00%	Size issued	50
29-Oct-08	500	2Y	VGB	14.70%	Size issued:	700
	200	5y		14.20%	Size issued:	300
30-Oct-08	500	2Y	VGB	14.50%	Size issued	450
31-Oct-08	300	5yr	VDB	15.00%	Size issued	190
	300	3yr	VDB	15.00%	Size issued	210
3-Nov-08	500	12mth	VGB T-notes	12.99%	Size issued	500
3-Nov-08	500	2Y	VGB	14.50%	Size issued:	450
4-Nov-08	300	3Y	VDB	15.00%	Size issued:	210
	300	5Y		15.00%	Size issued:	190
6-Nov-08	1,000	12mth	VGB T-notes	12.48%	Size issued:	800
10-Nov-08	1,000	12mth	VGB T-notes	11.88%	Size issued:	1000
12-Nov-08	500	2Y	VGB	11.90%	Size issued:	600
	500	3Y		11.50%	Size issued:	400
13-Nov-08	1,000	12mth	VGB T-notes	11.10%	Size issued:	1000
17-Nov-08	500	2Y	VGB	11.00%	**Failed**	
	500	5Y		11.00%	**Failed**	
17-Nov-08	1,000	12mth	VGB T-notes	10.50%	Size issued:	1000
18-Nov-08	200	3Y	VDB	11.00%	Size issued:	200
	300	5Y		11.00%	**Failed**	
25-Nov-08	200	3Y	VDB	10.74%	Size issued:	200
	300	5Y		10.90%	Size issued:	300
26-Nov-08	700	2Y	VGB	9.80%	Size issued:	140
	300	3Y		9.50%	Size issued:	100
27-Nov-08	500	2Y	VGB	9.50%	Size issued:	20
	300	5Y		9.80%	**Failed**	
27-Nov-08	300	12mth	VGB T-notes	9.00%	Size issued:	300
28-Nov-08	200	2Y	VDB	9.50%	**Failed**	
	300	5Y		9.80%	Size issued:	28
1-Dec-08	1,000	12mth	VGB T-notes	8.98%	Size issued:	1000
1-Dec-08	500	2Y	VGB	9.50%	Size issued:	20
	300	5Y		9.50%	**Failed**	
2-Dec-08	200	3Y	VDB	9.50%	**Failed**	
	300	5Y		9.80%	Size issued:	28
10-Dec-08	700	2Y	VGB	9.00%	Size issued:	100
	300	3Y		8.80%	Size issued:	100
15-Dec-08	500	2Y	VGB	9.00%	**Failed**	
23-Dec-08	200	3Y	VDB	8.98%	Size issued:	200
	300	5Y		8.70%	**Failed**	
30-Dec-08	200	3Y	VDB	8.50%	**Failed**	
	300	5Y		8.50%	**Failed**	

Source: HSBC Vietnam

FX strategy

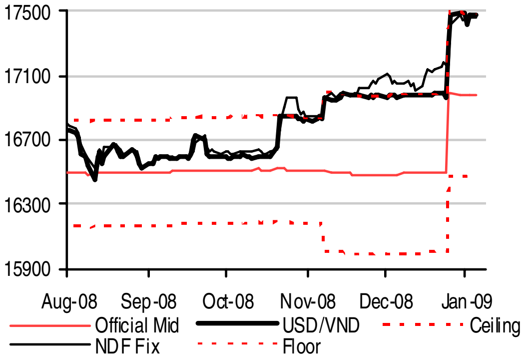
- The authorities set the USD-VND midpoint 3% higher on 25 Dec
- Better exchange rate regime management should keep the currency market more orderly and functional
- However, continued gradual trend depreciation is still in order

In December, the government announced a de-facto one-off devaluation of the currency by adjusting the official rate 3% higher. Leading up to this, the NDF fixings (our best estimate of the true market-clearing rate) had drifted up to be more than 1% above the band ceiling. In the days following the midpoint adjustment, both spot and the NDF fix traded below the new ceiling level. This suggests that the new trading band is set at a more appropriate level, and hopefully will promote better liquidity in the spot market in the near term. We had previously argued that adjustment of the official rate was better than currency band adjustments (the hitherto preferred method of achieving FX adjustments), as it makes policy more transparent and direct.

Better exchange rate regime management, some improvement in macro fundamentals, and a likelihood of limited further offshore position unwinding, mean that the FX markets should remain more orderly going forward. However, given the ongoing current account deficit and likely reduced capital inflows in 2009, we believe policy should continue to allow some gradual and modest weakening of the VND. Following this move, the 10% y-t-d depreciation in the VND (based on the NDF fixings) puts the dong merely in the middle of the pack in the broader Asian FX trend. Again, we argue the best approach towards the currency remains a gradually trending official rate more in-line with market supply and demand, rather than large one-off moves or band width adjustments.

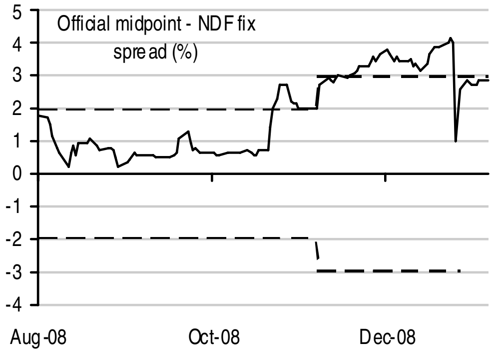
Daniel Hui

USD-VND, band, and NDF fix



Source: HSBC, Bloomberg

USD-VND onshore/offshore spread



Source: HSBC, Bloomberg

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