25/11/2009

BIDV Securities Co.,ltd

Quick Report

On raising of basic interest rate and ceiling foreign exchange rate of the State Bank of Vietnam

- These policies, for medium and long term would contribute to lessen imbalances of economics in the time coming, *reinforcing banking activities*, *preserving VND value, deduct inflation risk, stabilizing USD/VND rate and reducing national assets imbalances and bubbles..v.v..*
- As to securities market, these policies were considered positive solutions for medium and long term stability together with firm macroeconomic momentum

BSC Economic Research Team
BIDV Securities Company

BSC Head Office
10th Floor – Vincom Tower
191 Ba Trieu Str – Hanoi
Tel: 84 4 22200668
Fax: 84 4 22200669
www.bsc.com.vn

BSC Ho Chi Minh Branch
9th Floor – 146 Nguyen Cong Tru Str
District 1, Ho Chi Minh City
Tel: 84 8 3 8128885
Fax: 84 8 3 8128510

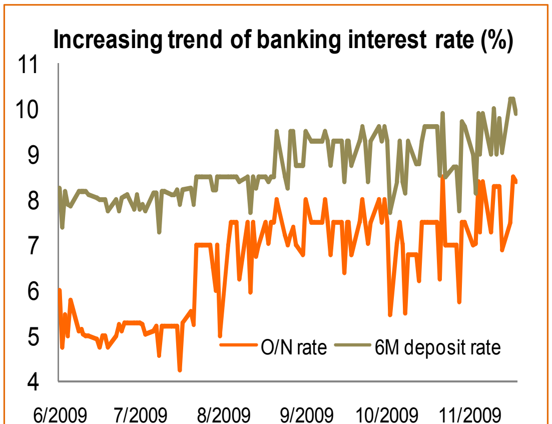
Hang Tre Transaction Office
20 Hang Tre - Hoan Kiem Dist- Ha Noi
Tel: 3 9261278, 3 9261276
Fax: 3 9261279

BSC Nam Ky Khoi Nghia Transaction Office
12-14 Nam Ky Khoi Nghia
District 1, Ho Chi Minh City
Tel: 84 8 8214803
Fax: 84 8 8214804

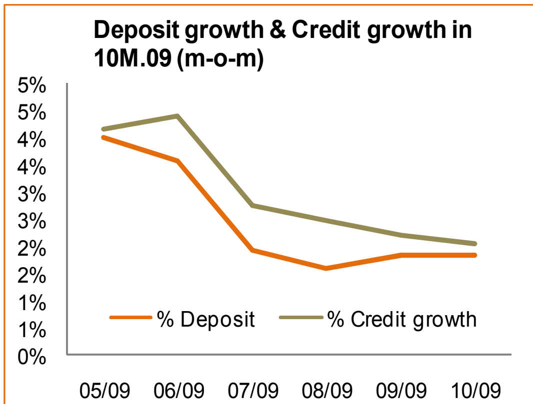
Comment and assessment on *SBV's decision to raise basic interest rate and ceiling exchange rate*

The State Bank of Vietnam on 25/11 decided to add 1% to the basic interest rate (from 7% to 8%). Accordingly, the ceiling interest rate has risen from 10.5% to 12% whereas currency band in exchange rate of USD against VND was narrowed from 5% to 3% amid the increase in interbank correlate interest rate. As a result, the ceiling exchange rate has risen to almost 18.500. Our assessment goes as follows:

- An increase in the basic interest rate is *necessary and consistent with objective evolution of the economy and market rules.* Previously, basic interest rate is forecast to be raised in Q1 of 2010 considering the fact that Vietnam is keeping up its stimulus policy with low interest rate. Still, as stated in our previous report (Q3/2009 Report), this took place earlier than anticipated, right in the Q4 of 2009. This is necessary for the following reasons:



Source: Bloomberg



Source: The State Bank of Vietnam

- *Promoting banks' activities when they have difficulties in capital mobilizing:* Due to high demand for credit at year-end, banks are facing difficulties in mobilizing capital, especially for medium and long termed capital. As a result, credit activity is also stricken with difficulties and banks' activities have almost been frozen for a month. Mobilization interest rate is continually pressed to rise in order to get out of this situation. In late 11/2009, the average deposit rate for 3-6 months term ranged from 8.7% to 9.3% (even 10.3% for several banks) with various kinds of promotion. ***<u>In banking system, monthly capital mobilization growth underwent an incessant fall from 4.01% in May to 1.5% in October 2009.</u>*** Until the end of October 2009, credit growth reached 33.3% while mobilization growth rate reached only 25.7%. The increase in average interbank interest rate and interbank transaction turnover partly demonstrates a shortage in commercial banks' capital.

Therefore, the real effect of raising basic interest rate is not to tighten but to unbind and loosen banks' credit activity. This is of great importance to the banking system and the balance of the macro-economy.

- *Improving VND's value:* In the middle of the continuously increasing value of USD and gold, raising basic interest rate would also improve the value of VND and ease the pressures for increasing exchange rate which may trigger negative effect on the macro-economy. While such foreign currency resources as exports or overseas remittance offer no further improvements than in 2009, the reduction in VND supply by increasing interest rate will be a tool for stabilizing exchange rate. The recovery of USD value generates significant effects as follows:

  - ✓ *Lesser difficulties and lower risk FX rate to import enterprises.* If FX rate were higher, Vietnam importers would pay much due to high exchange rate and USD shortage. Therefore, lowering the exchange rate will deflate and dismantle import difficulties Vietnam import, notably for importing of essential goods such as materials, manufacturing machines which account for 90% of Vietnam import structure.

  - ✓ *Foreign investment attraction*. Foreign investors will really be attracted to Vietnam only when VND is expected to be stable and stronger. Unstable exchange rate and VND devaluation will make Vietnam lose attraction to foreign investment capital.

  - ✓ *No more speculation of foreign currencies apart from VND.* Many people have made use of low VND interest rate and appealing VND loans to speculate other assets such as gold and currency, etc. which has created asset bubble mentioned in WB's recent report on Vietnam. We believe that while increasing VND interest rate, the SBV **may cut back USD lending rate** in order to strengthen VND against USD. This will ease the exchange rate and minimize speculation which increases asset bubble in the economy.

  Ceiling exchange rate increase will make enterprises boost selling foreign currency to banks, reducing foreign currency flow on the black market, contributing to easing the exchange rate.

- *Stabilizing the macro-economy and preventing inflation:* A rise in interest rate shows that macro-economic policies are for money tightening for a stable stage with higher quality and lower risks. This complies with the policy on short termed interest rate assistance which expires on 31/12/2009 (according to a statement of SBV on 25/11/2009) as interest rate assistance policy and an increase in interest rate obviously go against each other in theory.

Furthermore, inflation in 2010 is also of great concerns. Although there is no unusual sign at present, inflation lag against monetary policy is also an explanation for raising interest rate from now on. With lessons learnt from inflation in Vietnam in the past, in our opinion, this is absolutely a right decision.

Conclusion:

- Basic interest rate raised by 1% and the ceiling exchange rate of USD/VND adjusted will help stabilize the macro-economy. These policies will reduce macro-economic imbalance in the long run and will ***intensify bank's activities, promote VND value, diminish inflation risk, stabilize exchange rate and reduce maladjustment and asset bubbles, etc.***
- Regarding the stock market, these policies will have positive impacts on the market in a long and medium term. ***The stock market will enjoy stability only if macro-factors remain healthy and macro-economic policies are amended in time in accordance with the market trends***. We regard the increase in basic interest rate and ceiling exchange rate as a proper policy which is of positive significance to the stock market in a view of medium and long term.

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BSC Economic Research Team
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BIDV SECURITIES COMPANY (BSC)

BSC Head Office
10th Floor – Vincom Tower
191 Ba Trieu Str – Hanoi
Tel: 84 4 22200668
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12-14 Nam Ky Khoi Nghia
District 1, Ho Chi Minh City
Tel: 84 8 8214803
Fax: 84 8 8214804

Research Team

Nguyen Thi Thu Trang
Nguyen Ngoc Anh

Editor:
Vu Thang Binh
Manager of the Analysis & Research Department
Tong Minh Tuan
Manager of Economics