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Recent data out of Vietnam continue to suggest that the government's measures to stabilize the economy and restore investor confidence are paying off.

Bond Market Warming Up

Vietnam's State Treasury had another successful bond underwriting session yesterday, raising around VND1.5 trillion (US\$90 million). The Treasury sold VND835 billion worth of 2-year bonds and VND695 billion worth of 3-year bonds, both with a coupon of 16.5%. This was 100 basis points below the last underwriting session on 8 August. Offshore accounts played a strong part in the session and took up the majority of the issuance, but onshore accounts were also seen participating. The yield on the benchmark 5-year government bonds has now fallen to 16.6%, and the 5-year sovereign CDS spread has narrowed by 75 basis points since its mid-June high, although it still remains well above levels seen in late 2007.

Vietnam - Sovereign CDS Spread (5 yr)



Vietnamese Dong Implied NDF Discount Declining

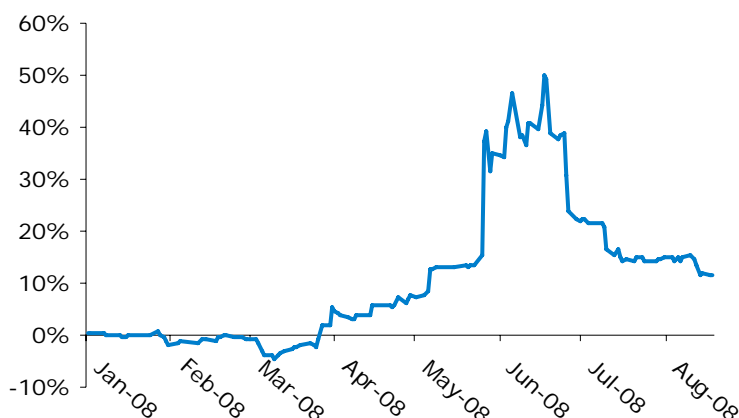
The implied NDF discount (computed as the difference between the VND 12M forward rate against the VND/USD spot rate, in percent) has continued its downward decline that began in mid-June. The discount has narrowed

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significantly from a high of 49% on 19 June 2008 to 11.5% on 19 August.

Vietnamese Dong - Implied NDF Discount



Source: Bloomberg

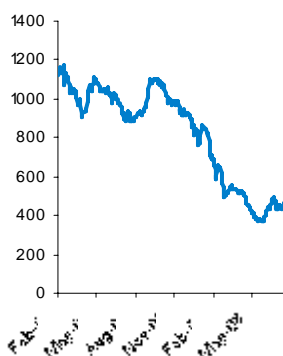
This measure, which we interpret mainly as a gauge of foreign investor sentiment on the probability of a large devaluation, suggests that fears of such an event have faded significantly, but not disappeared entirely.

Stock Indices Beginning to Recover

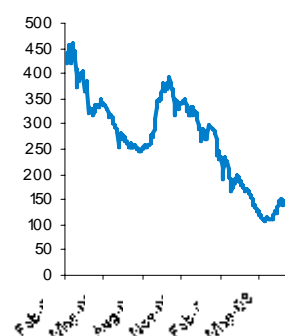
On the equity front, both the Ho Chi Minh and Hanoi stock markets have rallied sharply since mid-June, with significant net buying from foreign investors, which has been positive in every week since May, except one. The Ho Chi Minh stock index is up by 39% from its low in June, while the Hanoi stock index is up by 47%. That being said, both indices remain well below their highs of late 2007.

Trading activities in the equity market will be further boosted by the government's announcement on 14 August to widen the trading limits for share movements on its two domestic stock exchanges. The limits for the Ho Chi Minh City Stock Exchange and Hanoi Securities Trading Centre have been widened to 5% (from 3%) and 7% (from 4%), respectively.

Ho Chi Minh Stock Index



Hanoi Exchange Stock Index



Source: Bloomberg

Conclusion

These positive signs indicate that investor confidence is slowly returning to Vietnam, and suggest that the stabilization measures implemented in June are beginning to bear fruit. We would also note that inflation, which we will be examining in greater detail in an upcoming paper, is also easing owing in part to favourable (exogenous) developments in food and commodity prices.

However, in our view it is too early to declare victory. As we noted in "The Confidence Game" (17 June 2008), growth needs to slow in order to restore macroeconomic and financial balance. This means that interest rates need to remain at levels that (i) make it attractive for domestic savers to hold dong-denominated deposits and (ii) result in credit growth commensurate with a more moderate pace of GDP and import growth. In addition, the apparent normalization in the currency market needs to reflect genuine responses to market prices rather than the outcome of administrative or other stop-gap measures.

The key risk at this juncture is that the authorities may relax policies too soon, resulting in a renewed surge in imports and renewed downward pressure on the dong. That would be a pity as it would nullify the gains achieved to date.

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