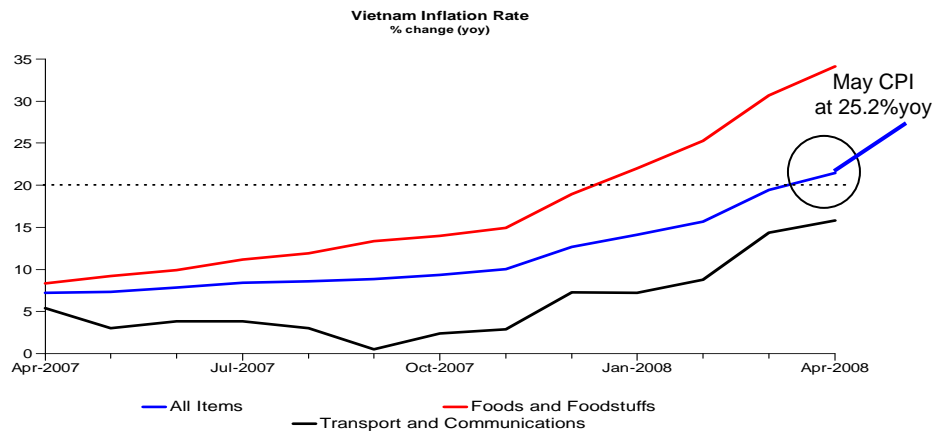


THE INFLATION CRISIS IN VIETNAM

Friday, May 30, 2008

Vietnam's May CPI growth hit a high of 25.2% yoy, the most since at least 1992, and mainly driven by food prices (+67.8%) amid a poor rice harvest and a global spike in food prices. Meanwhile, export growth slowed to 24.4% yoy in May. The trade deficit has spiked and is likely to widen to a record US\$14.4 billion for January to May 2008, exceeding the 2008 deficit target of US\$10.9 billion and 2007's trade deficit of US\$12.4 billion.

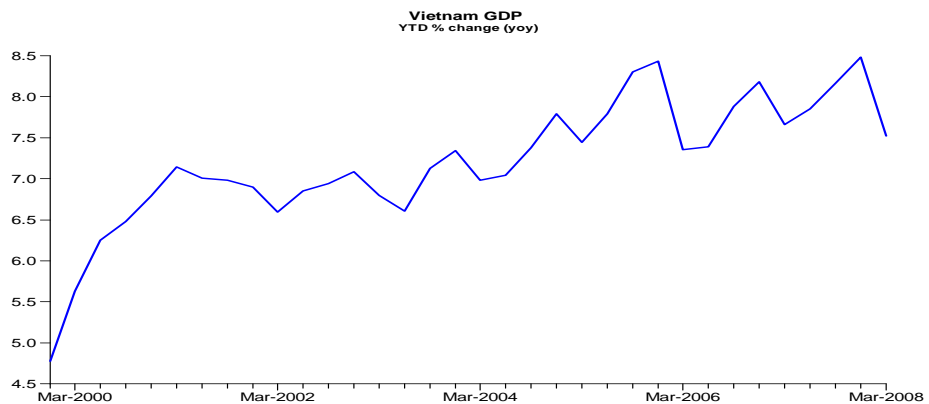
Vietnam's inflation – up, up and away



Source: CEIC, OCBC BANK

The government had recently downgraded its GDP growth target from 8.5%-9% to 7%, and expects the current account deficit to hit 5% of GDP this year and 7.5% of GDP in 2009. Given that Vietnam's financing is highly dependent on non-FDI capital inflows, the economy looks increasingly vulnerable.

Vietnam's growth momentum is slowing



Source: CEIC, OCBC BANK

Corporate FX & Structured Products  
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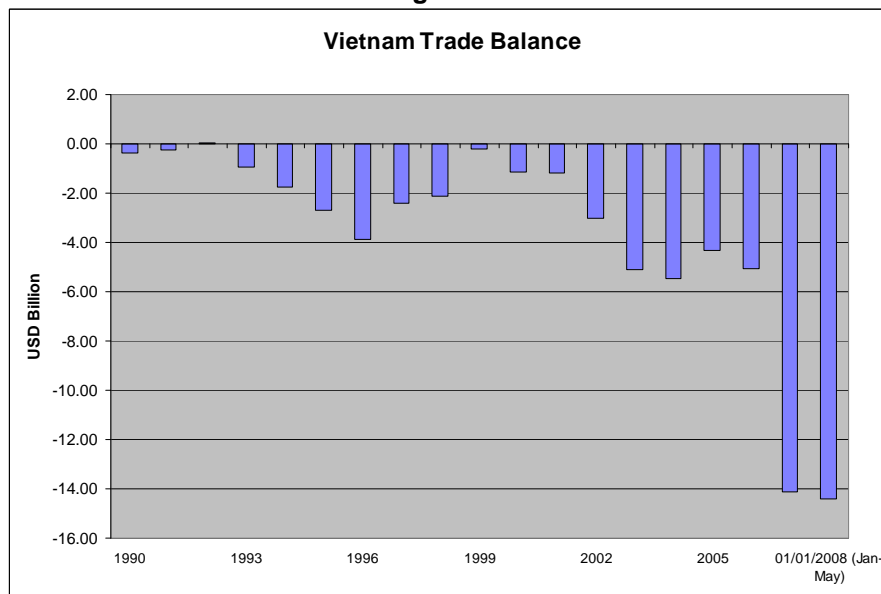
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### Trade account deteriorating fast in first five months of 2008



Source: CEIC, OCBC BANK

On the interest rate front, the State Bank of Vietnam had hiked its main interest rate from 8.75% to a base rate of 12% (highest since introduced in 1998) from 19 May, and would allow banks to set their own deposit rates to help improve liquidity, provided they do not exceed 150% above the base rate announced monthly by the central bank (ie. 18%). Faced with accelerating inflation, ordinary Vietnamese are cited to be draining bank accounts and buying gold and hoarding USD instead.

Meanwhile, property stocks have slumped amid concerns that the higher borrowing costs will adversely hit home purchases and stress the banking sector further. Market estimate is that loans growth which exceeded 50% last year, may see a sharp moderation this year. Any sharp depreciation of the VND would also hit borrowers and banks given that almost one-quarter of system-wide loans are in USD. The Ho Chi Minh Stock Index, which has fallen 55% for the year-to-date, has been closed since Monday due to a computer system problem, re-opens today.

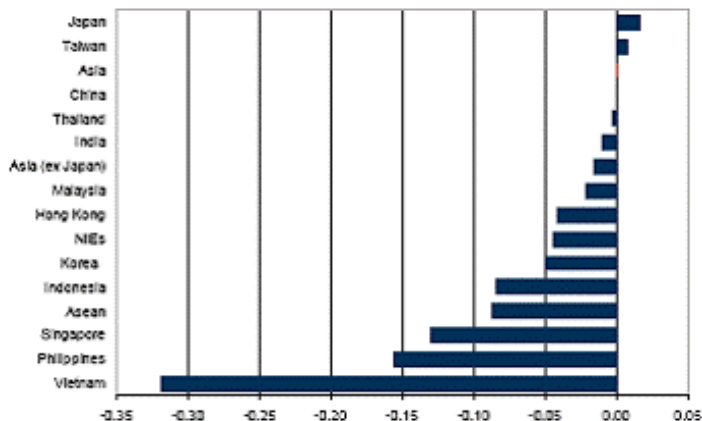
Both Standard & Poor's and Fitch Ratings services have cut Vietnam's sovereign rating from stable to negative due to the rising macroeconomic risks and citing risks to the stability of the banking system, which is highly dollarised by regional standards. Fitch stated that "The policy response has been both too slow and too small" when facing the rising inflation, "as official pronouncements have not been followed up by immediate action – and too small, as real policy interest rates remain deeply negative even following their recent increase". S&P said it could cut Vietnam's sovereign rating if situation worsens. **As such, the risk of a hard landing scenario looks increasingly likely.**

Following Vietnam’s accession to the World Trade Organization, some market commentators have questioned if Vietnam’s growth was “too much, too fast”. Some of the problems that Vietnam is facing today appear symptomatic of Thailand before the 1997 Asian crisis. That said, Vietnam’s government debt at end-2007 is equivalent to 38% of GDP, of which more than 50% was external concessional loans. The mitigating factors are that external interest payments are equivalent to less than 2% of current external receipts, and the official FX reserves of US\$24 billion at end-2007 exceed the country’s gross external debt.

Despite the recent VND volatility, the State Bank of Vietnam states that “the exchange rate continues to be managed in a stable direction, with the level of fluctuation in 2008 at plus and minus 2% as approved by the prime minister”. The VND band was last widened in March from 0.75% to 1.0%. While the recent plunge in the VND may be over-done, there may be little let-up in the near-term pressure amid runaway inflation and signs that the central bank is running out of options to combat inflation. Going ahead, the stress on the currency may continue to build on the back of runaway inflation, the widening trade deficit (and current account) and tight liquidity within the banking sector. The NDF market has reacted in line with worsening investor sentiment with premiums spiking in recent sessions. We feel the shorter end of the curve (1-3M) may already be priced for any negative impact (3M looking for a 42% depreciation) on the currency front, although the longer end (6-12M) may see better value (12m currently looking for an 18% depreciation) if expectations are for the currency to eventually cave under negative fundamental pressure with a woefully inadequate foreign reserve kitty.

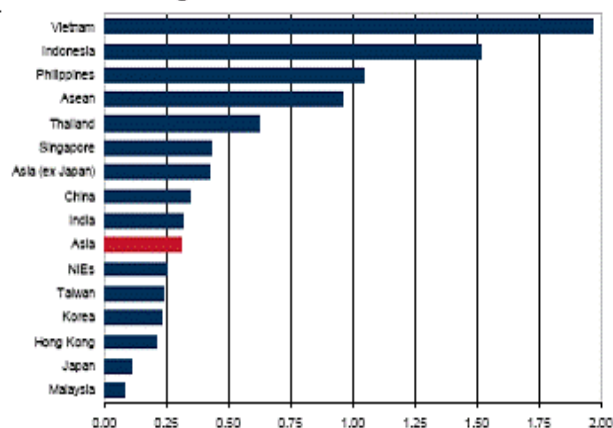
**Sharpest growth downgrade and inflation upgrade in Asia**

Change in 2008 GDP Growth Forecast



Note: Change between May and June 2008 in percentage points.  
Source: FocusEconomics Consensus Forecast.

### Change in 2008 Inflation Forecast

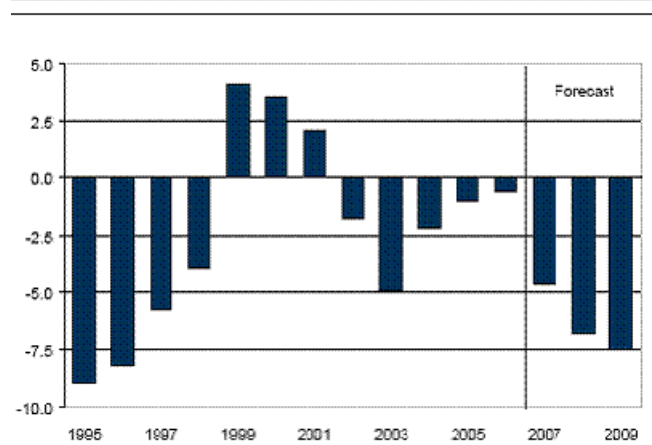


Note: Change between May and June 2008 in percentage points.

Source: FocusEconomics Consensus Forecast.

### Rapid current account deterioration

Current Account, % of GDP



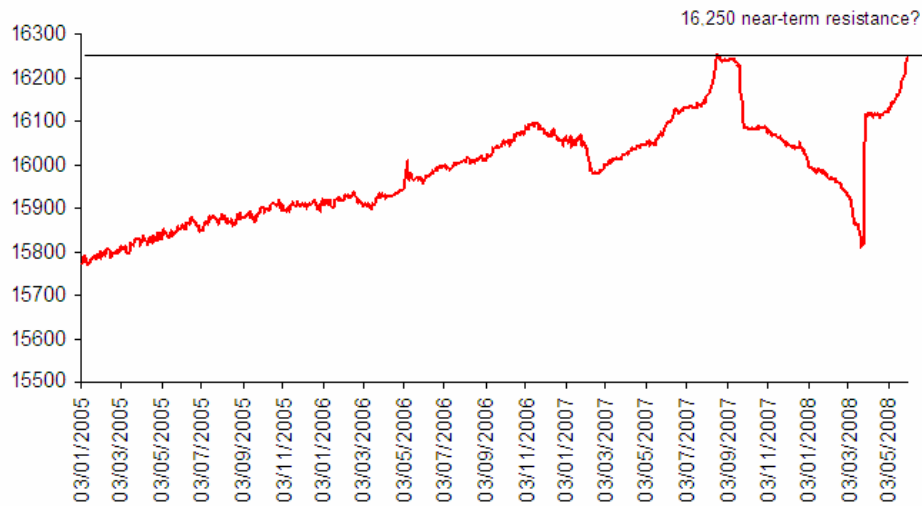
Source: FocusEconomics

### Little margin for policy errors

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Population (million)	74.3	75.5	76.6	77.6	78.7	79.7	80.9	82.0	83.1	84.1	85.2	86.3
GDP (US\$ billion)	26.8	27.2	28.7	31.2	32.7	35.1	39.6	45.5	52.9	60.9	71.1	88.2
GDP per capita (US\$)	361	361	374	402	415	440	489	554	637	724	835	1,022
GDP (annual variation in %)	8.2	5.8	4.8	6.8	6.9	7.1	7.3	7.8	8.4	8.2	8.5	7.5
Consumption (annual variation in %)	5.7	4.3	1.8	3.2	4.7	7.4	7.9	7.2	7.5	7.6	8.1	8.0
Investment (annual variation in %)	10.2	12.4	1.6	10.2	10.7	12.9	11.9	10.4	11.0	8.6	11.5	10.9
Unemployment (%)	-	6.9	6.7	6.4	6.3	6.0	5.8	5.6	5.3	4.4	4.3	4.2
Fiscal Balance (% of GDP)	-2.5	-0.7	-2.2	-3.3	-4.0	-1.8	-1.8	-1.1	-1.6	-1.8	-2.4	-2.4
Consumer Prices (annual average in %)	3.2	7.8	4.3	-1.6	-0.4	4.0	3.2	7.7	8.3	7.5	8.3	15.1
Interest Rates (benchmark in %, eop)	10.8	12.0	6.0	6.0	4.8	4.8	5.0	5.0	6.5	6.5	8.3	8.2
Exchange Rate (vs. US\$, end-of-period)	12,292	13,890	14,028	14,514	15,084	15,403	15,646	15,777	15,916	16,055	16,020	15,768
Current Account Balance (US\$ m)	-1,528	-1,074	1,177	1,107	682	-603	-1,931	-957	-519	-299	-3,297	-5,989
Current Account Balance (% of GDP)	-5.7	-3.9	4.1	3.6	2.1	-1.7	-4.9	-2.1	-1.0	-0.5	-4.6	-6.8
Trade Balance (% of GDP)	-9.0	-7.9	-0.7	-3.7	-3.6	-8.7	-12.9	-12.1	-8.6	-7.9	-13.0	-15.8
Exports (annual variation in %)	26.6	1.9	23.3	25.5	3.8	11.2	20.6	31.4	22.5	22.1	22.1	22.6
Imports (annual variation in %)	4.0	-0.8	2.1	33.2	3.7	21.8	27.9	26.6	15.7	20.1	29.7	27.1
International Reserves (US\$ m)	1,986	2,002	3,326	3,417	3,675	4,121	6,224	7,041	9,051	13,384	22,172	26,660
Int. Reserves (months of imports)	2.1	2.1	3.4	2.6	2.7	2.5	3.0	2.6	2.9	3.6	4.6	4.4
External Debt (% of GDP)	81.1	82.5	80.9	41.1	38.5	38.1	40.4	39.7	36.4	31.9	31.5	29.2

Source: FocusEconomics

### Vietnamese Dong - A Weakening Trend to Continue?



Source: Bloomberg, OCBC

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