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Vietnam Devalues Dong by 7%, Risking Faster Inflation (Update3)
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(Adds Citigroup comments in fifth paragraph.)

By Bloomberg News

Feb. 11 (Bloomberg) -- Vietnam devalued the dong by about 7 percent, the most since at least 1993, risking faster inflation to curb the nation's trade deficit and narrow the gap between official and black-market exchange rates.

The dong slumped to as weak as 20,893 per dollar, compared with 19,498 yesterday, and was at 20,875 at 4:45 p.m. in Hanoi. The State Bank of Vietnam fixed the reference rate for the currency at 20,693 versus 18,932 yesterday, or 8.5 percent weaker. The trading band for the currency was narrowed to 1 percent on either side of the rate from 3 percent previously.

Vietnam's fourth devaluation in 15 months takes place with its inflation rate at the fastest in almost two years, and with the International Monetary Fund describing its foreign-currency reserves as being "low." While the whole of Asia outside Japan is struggling to curb inflation, countries such as China, Taiwan and Singapore have strengthening currencies and rising foreign- exchange reserves.

"There is still a crisis of confidence out there," said Nizam Idris, a strategist at UBS AG in Singapore. "There's still more pressure for the currency to depreciate some more."

The "ceiling" beyond which the dong can't weaken is more relevant to the market than the daily fixing rate, making the effective devaluation 6.7 percent to 20,900 per dollar from 19,500 previously, wrote Johanna Chua, the Hong Kong-based head of Asian economic research at Citigroup Inc.

Black Market

The currency weakened this afternoon on the black market to as much as 21,550 per dollar from 21,300 yesterday, based on figures given by a telephone information service run by Vietnam Posts & Telecommunications.

"This is an overdue attempt to get the currency market under control," said Kevin Snowball, chief executive of PXP Vietnam Asset Management in Ho Chi Minh City. "You can't just leave a 10 percent differential between the official and black- market rates without destroying the credibility of the entire currency regime."

The devaluation may ease a drop in foreign-exchange reserves and calm the market at the risk of boosting imported inflation, wrote Tai Hui, the Singapore-based head of Southeast Asian economic research for Standard Chartered Plc.

Price Stability

"Higher interest rates are still needed to maintain price stability and prevent further dong sell-offs," Hui wrote in a research note today. “The credibility of the State Bank of Vietnam needs improvement given repeated one-off devaluations.’

While the central bank’s so-called base rate has held at 9 percent since November, market interest rates have climbed to as high as 20 percent, Ho Chi Minh City-based Viet Capital Securities said last week.

IMF View

The International Monetary Fund, which in December called for a further tightening of monetary policy to “restore orderly conditions in the foreign-exchange market” and contain inflation, said today that it welcomed the attempt to narrow the gap between the official and parallel market exchange rates.

Still, Vietnam also needs “a broader set of policies to restore macroeconomic stability,” said Benedict Bingham, the IMF’s senior resident representative in Vietnam. “Monetary policy will need to focus more decisively on containing inflation, and fiscal policy will need to be put on a clearer consolidation path to contain public debt.”

The monetary authority had already devalued the dong in November 2009 and February and August last year, amid concern the nation will run short on foreign capital needed to fund a trade deficit, which reached $1 billion in January, according to preliminary government figures.

While the official exchange rate of the currency had been little changed since the August 2010 devaluation, on the black market the currency weakened from about 19,500.

“We paid 20,500 per dollar in December and 20,800 in January,” said Alan Young, chief operating officer of Australian-listed Vietnam Industrial Investments Ltd., which runs steel plants in the northern port city of Haiphong. “You just can’t buy dollars at the official rate.”

Currency reserves probably fell to about $13.6 billion at the end of last year, down from $14.1 billion in September and $23.9 billion in 2008, according to Citigroup Inc.

‘Very Steep’

The devaluation is “very steep,” said Dariusz Kowalczyk, senior economist at Credit Agricole CIB in Hong Kong. “It seems the authorities are trying to support exports and to support growth, rather than to fight inflation. That’s very surprising because inflation in Vietnam is a major problem.”

The central bank said the measures will help “manage the exchange rate more flexibly” and curb the trade deficit.

“We will adjust the reference rate more flexibly, more often now, depending on the market demand, instead of leaving the rate fixed for a long time,” said central bank Deputy Governor Nguyen Van Binh.

Moody’s Investors Service cut Vietnam’s sovereign credit rating in December, citing the risk of a balance-of-payments crisis and a drop in foreign reserves as inflation accelerates and the currency weakens. Consumer prices increased 12.17 percent last month from a year earlier, compared with 11.75 percent in December, according to the statistics office.

“One of our top priorities now is to stabilize the macro economy in order to maintain the pace of growth,” Nguyen Van Thao, deputy chief administrator of the ruling Vietnamese Communist Party’s Central Committee, said on Jan. 19. The government forecasts the economy will expand by up to 7.5 percent this year, compared with 6.78 percent in 2010.

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