DRAGON CAPITAL

VIETNAM: 7.2% DEVALUATION

MACRO UPDATE

Gov't finally devals by 7.2% to 20,900, but VND has been floating for a while

To no one's great surprise, the SBV has finally devalued the Dong. This morning it cut the USD reference rate from 18,932 to 20,693 and narrowed the trading band from ±3% to ±1%. In practise this means that the commercial rate, at the top of the band where deals actually take place, goes from 19,500 to 20,900. This a 7.2% hit, which seems huge, but there is a twist. The new rate has actually prevailed in business transactions for the past four months, and was moving up before that too, so we believe the de-val will not have a drastic impact on macro outcomes. Tellingly, there was little reaction in the stock market. One should really think about the pressures from a quasi-float in place for at least a year now.

Business long since reflected 20,600-20,900 and deval will mostly hit SOEs

The interbank rate, where corporates trade, has fluctuated in a 20,600-20,900 channel going back to late October. In the past several weeks it has been at the top of that range. So the Central Bank has simply ratified the reality in the street by moving the official rate to the interbank rate. The effect will mostly be confined to players which have been doing business on the old rate - namely, the SOEs, who will see special privileges eroded.

Neutral effect on 2011 trade deficit where we maintain ca $12bn forecast

In terms of a somewhat neutral result from the deval, there is first of all the trade deficit. The country's price-sensitive manufactured exports, which are 60% of the total and largely come from the private sector, have been getting primed to benefit from a cheap currency for a while now. In the remaining 40% of exports, which are commodities, the country is already a price-taker. As for imports, the private sector accounts for a big chunk - we reckon at least two thirds - but has been buying them at real-world rates for some time. SOEs have had no such cushion. They have received dollar funding at the official rate and are now faced with at least 7-9% higher costs. In an environment where monetary policy is being tightened and the budget deficit lowered, we suspect the SOEs will have to cut back. Net net, we continue to forecast the 2011 trade gap at $12bn.

2011 inflation forecast also maintained, at 10% yoy by Dec

As for inflation, normally, we would estimate that first- and second-round effects of a deval would add a total 18 bps to the CPI. But once again, with the lengthy lead-up to the VND adjustment, we think much of the effect has already started to flow. Hence we stick with our forecast on inflation as laid out in recent reports. The CPI will stay at 12-13% into mid-year, peak at 13-14% on the low base factor, then head for 10% by year-end

Big deval shows Gov't serious, though everything depends on policy follow-up

This devaluation is the biggest since the Asian Crisis and the Government is aware that it must be seen to make it stick. So we are betting that there will not be any near-term weakening. We believe that the MoF and SBV aim to stop quasi-regular adjustments to the currency and have understood that this only creates "depreciationary expectations". Their plan is to restore confidence with a stronger policy and this is what the more disciplined monetary and fiscal stance, increased SOE restraints and tougher bank regulation are all about. In the short-term, the Government may spend reserves here and there, and force SOEs to sell dollars, and use administrative measures to rein in speculators. It has built in extra control, of course, by narrowing the band. But ultimately the onus is on policy. With a view that this is forthcoming, we would see the VND at not much more than 21,500-22,000 by year-end.

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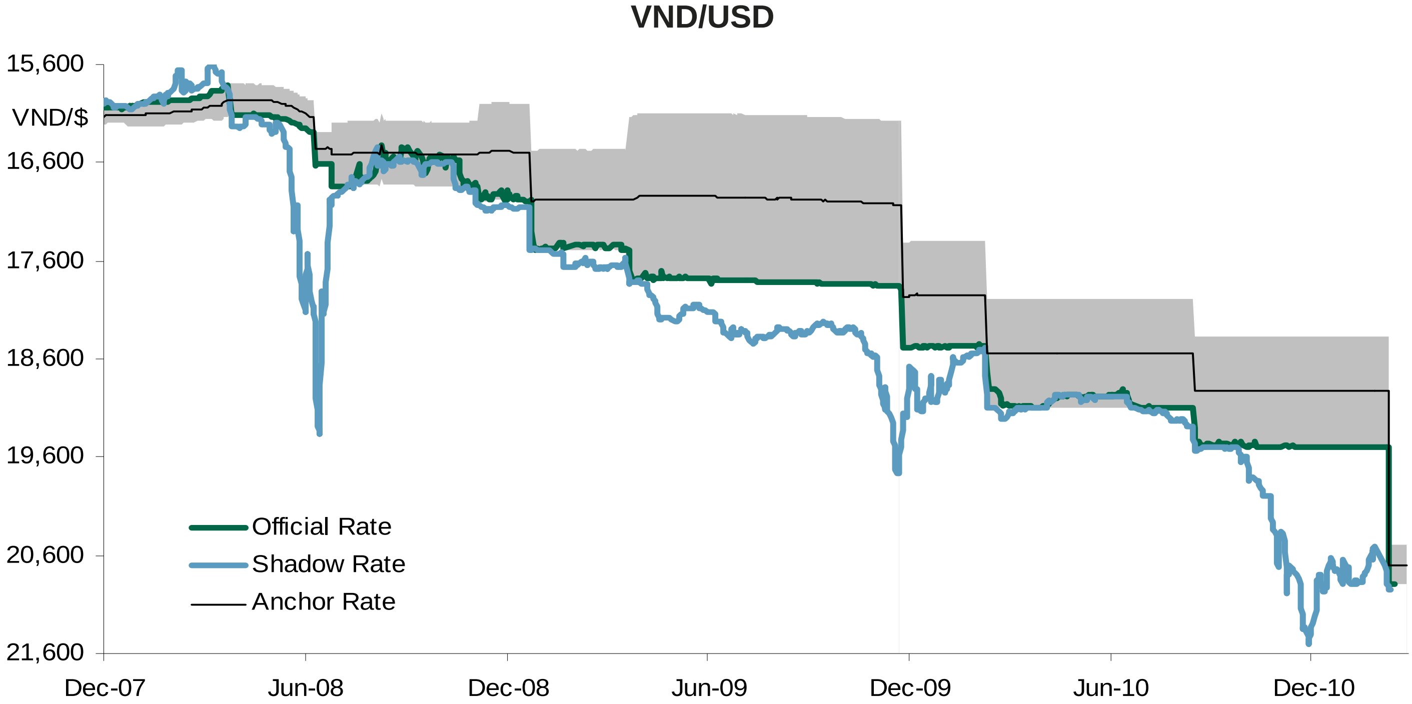

BALANCE OF PAYMENTS, 2007-11

($bn)	2007	2008	2009	2010E	2011F
Trade Account (fob)	(10.4)	(12.8)	(8.3)	(7.1)	(6.1)
Services	(0.8)	(0.8)	(1.1)	(1.2)	(1.6)
Net Investment Income	(2.2)	(4.4)	(4.5)	(4.0)	(4.2)
Remittances	6.4	7.3	6.5	7.8	8.0
Current Account	**(6.9)**	**(10.7)**	**(7.4)**	**(4.5)**	**(3.9)**
Debt Repayment	(1.4)	(1.5)	(1.1)	(1.5)	(1.7)
ODA Flows	2.0	2.5	5.1	3.2	3.3
Net FDI	6.6	9.3	6.9	7.6	7.7
Net Portfolio Flows	6.2	(0.4)	(0.2)	2.4	2.1
Other Net Financial	4.3	2.4	1.2	1.7	1.9
Capital Account	**17.7**	**12.3**	**11.9**	**13.4**	**13.3**
Errors & Omissions	**(0.8)**	**(1.3)**	**(12.2)**	**(12.1)**	**(8.1)**
BOP = Ch in Reserves	**10.1**	**0.3**	**(7.8)**	**(3.2)**	**1.3**
RESERVES	23.5	23.8	16.1	12.9	14.2
Months of Imports	4.8	3.8	2.9	2.0	1.9
Ext Debt/GDP - %	32.5	29.8	39.0	44.0	47.0