

Vietnam

Stop-gap solution: the SBV lowered the OMO rate by 50bp

The central bank of Vietnam lowered the OMO rate today by 50bp to 5.5%. The move is likely intended to ease the recent liquidity crunch, which caused overnight interest rates to rise to its highest level this year. With inflationary pressures elevated due to a recent gasoline price hike, potential rise in public service costs, and cost pressures caused by the recent VND devaluation, the SBV is unlikely to cut rates further.

Facts

- The State Bank of Vietnam (SBV) cut the open market operation (OMO) rate by 50bp to 5.5% from 6.0% today. Year-to-date, the SBV has lowered the OMO rate by a cumulative 150bp, from 7% at end 2012
- The entire OMO offer of VND7trn at 5.5% was absorbed by banks
- Overnight (O/N) interest rates have shot up in recent days due to limited liquidity; the O/N rate was at its highest level this year today

Implications

The central bank is trying to ease liquidity conditions by lowering interest rates. While the OMO offer volume will likely ease some of the liquidity squeeze, it is unlikely to solve the fundamental issues surrounding Vietnam's meager credit growth. The central bank's promise to open an asset management company (AMC) on 9 July 2013 was delayed. While the AMC was not expected to be a panacea to Vietnam's non-performing loan issues, its operation is symbolic in signaling the government's commitment to tackle the inefficiencies in the economy.

The room to cut rates further has narrowed. The recent VND weakness coupled with accelerated inflation and higher oil costs suggests that headline inflation will likely rise to 7.1% y-o-y in July from 6.7% in June. Dampened domestic demand and a favorable base effect will likely push inflation lower towards the end of 3Q 2013.

However, upside risks to inflation remain. The government may be motivated to hike public service costs given weak revenue collection. Commodity prices might rise due to an expected acceleration of global growth in 4Q 2013. Further reductions of rates will likely add to inflationary pressures.

We believe today's move is rather reactionary to recent credit conditions and rates are unlikely to be lowered further. With a rising interest rate environment globally, the lowering of the OMO rate could trigger outflows, further exacerbating the liquidity crunch, and possibly push term rates higher. The SBV is unlikely to lower rates further after today's decision.

Bottom line

The SBV lowered the OMO rate today in order to ease market liquidity conditions, in reaction to the sharp rise in the overnight interest rate today. With core inflation in the double-digits and headline inflation expected to accelerate in July, the SBV's has limited room to cut rates further. We expect rates to stay steady, if not move higher, from now on.

Disclosure appendix

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