

Starting point

In yesterday's *Infobox* we gave the macro economic conclusions of our visit to Vietnam. Briefly they are that the country's infrastructure requirements are huge, but that the government recognises that it needs to compete for foreign capital and help its indigenous entrepreneurs generate the growth needed to achieve the government's impressive poverty reduction targets. In this *Infobox* we look specifically at what this might mean for Vietnam's capital markets.

The quick answer is that the commitment to (and necessity of) encouraging private capital means that Vietnam's capital markets will continue to develop. However they need to; the present situation is not especially favourable either for international investors or local savers. The stock market is tiny; the Vietnam Stock Exchange comprises 36 stocks, their market capitalisation is only 0.7% of 2005 GDP. In addition there is an unofficial/OTC/grey market (no-one quite seemed to know what to call it). This is larger but lacks transparency or legal recourse or fair access to information; it is more like the Wild West than a viable investment vehicle. Certainly no-one was willing to vouch for its efficiency as a way of allocating savings. For international investors this means the stock market lacks depth and liquidity is minimal. For the economy it means that the bulk of capital allocation takes place through the banking system.

And the picture painted of Vietnam's banks was not a rosy one. The country is "over banked but under serviced". Savers are poorly served and so are potential borrowers. One predictable result is that, as property is one of the few avenues for investment, property prices are not surprisingly high.

For foreign banks and financial institutions this makes for attractive market opportunities. HSBC and ANZ among others are already active. At the end of 2005 HSBC additionally announced that it was acquiring 10% of Techcombank, Vietnam's third

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largest joint stock bank. And it was Techcombank's CEO, Nguyen Duc Vinh, who was most candid on the problems that the banking system faces.

Banks are capital deficient and are therefore keen to list. However this is not the only impediment. For Mr Vinh deficient legal infrastructure is more important, retarding bank development by making SME and consumer lending a high risk business. The credit card business is frustrated by a lack of credit data. The banking and business culture, we were told, has not changed enough to ensure that bank capital is adequately used.

The listing of banks does promise to grow the stock market. Though a large number of SOEs have been "equitised" the number of large companies has so far been small. And if the equity markets are underdeveloped the debt markets are even more so. The government launched a US\$ sovereign bond last year (which now yields only 159bp over Treasuries), aside from fund raising the intent was also to act as the beginnings of a benchmark for corporate bonds. But here too present infrastructure is lacking. Vietnam does not have a domestic credit rating agency. While borrowers were government or quasi-government this didn't really matter. But if private companies are to borrow in the debt markets it will do so.

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This all seems pretty negative stuff but, as with the broader macro picture the reason that we are optimistic is that the government realises that things have to change (indeed the *reason* that we are optimistic on the economy is because of changes in how capital is allocated). But forming a balanced judgement requires not only for us to know that change is happening but where it is coming from. The base is low the improvements will take time. Vietnam is a great growth story but it is more a 5-10 year one than 2-3 years. In Hanoi, everyone was in agreement on this one issue.

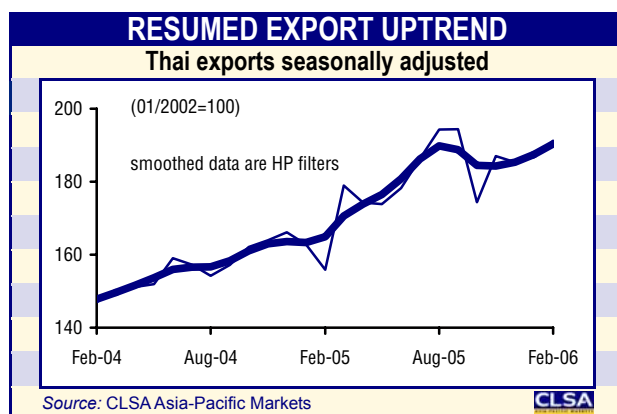
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Good export tidings

Thailand's export trend has turned up again according to the provisional commerce data, good news if it is confirmed by the definitive trade release at the end of next week. Exports rose by 23% YoY in February for a renewed upturn after slowing export growth in the fourth quarter. Strengthening exports will have probably kept the February current account in surplus (even with the trade balance in deficit) supporting the exchange rate in this turbulent political period.

We usually downplay the provisional trade data because they have sent incorrect signals on more than one occasion. We have chosen to comment on the February commerce data because of the strong signal on renewed export strength. If the 23% growth is confirmed next week, it will lift the export trend above the previous peak in August 2005 (see chart).

Imports were also strong in February rising by 19% YoY. Imports were only slightly outpaced by exports



leaving the trade account in deficit. However, there will likely be an offsetting services surplus which on recent trends should result in an overall surplus on the current account. If this is confirmed next week, it will be the eighth consecutive monthly current account surplus, a positive counter to the political uncertainty hanging over the market. So far though, the improved current account position has not influenced the Bank of Thailand (BOT) to ease its monetary stance. We were disappointed by the BOT's decision to hike rates earlier this month fearing that excessive monetary tightening will start to squeeze domestic demand.

And import strength was not a reflection of firm domestic demand. Imports were boosted by a 78% YoY rise in oil imports along with aircraft imports valued at almost 3% of the total monthly import bill.

We do not have the full export breakdown. But it appears that demand from China has been critical. China imports from Thailand surged by 33.8% YoY in the first two months of the year.

However, we believe that demand from China will drop sharply over the course of this year due to consolidation in its overcrowded industrial sector. For Thailand, as external demand fades, it will be left to domestic investment to lead growth. We have argued that conditions are conducive for an investment rebound, with firms operating at high levels of capacity utilisation and interest rates still low in real terms. Business sentiment will be the swing factor though, with increasing risk the longer the political standoff persists.

Delayed investment plans mean that capex growth this year may not be as strong as we anticipated (see **Out & About: In Thailand** January 2006). But one way or another, we expect that the political crisis will be defused. The outlook at that point will look decidedly brighter. The government has hinted that the corporate tax rate will be cut, just the thing to lift investor sentiment.

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