

Alan Pham, PhD
Chief Economist
T: +848-3821-9930 ext 233
alan.pham@vinacapital.com

All major indicators of the economy heading in the right directions. More improvement is expected for the rest of this year.

- **Economic growth is subdued in January due to a long holiday period** that left only 16 working days for the month. Industrial production declined 2.4% YOY. Retail sales were weak due to purchasing power of consumers being lowered by continuing high inflation.
- **Bank liquidity emerges as a critical problem.** At first, the consensus was that a large pool of capital is locked up in uncollectible Real Estate loans. A re-structuring of the banking system is the best way to unblock the situation. A promising start was made with a 3-bank merger in December.
- **5 to 8 more banks are slated** for consolidation in Q1-12, following the same model, with the assistance of a major state-owned bank.
- **The interbank market also comes to the fore as a place where many loans are not being re-paid**, or not re-paid on time. This is reminiscent of a collapse of the global commercial paper market after a declaration of bankruptcy by Lehman Brothers.
- **Inflation started the year at a moderate rate of 1.0% MOM, or 17.3% YOY.** The downtrend is continuing thanks to a tight policy framework remaining in place.
- **The exchange rate VND/USD stays stable**, and even shows some improvement in favor of the VND when free market rates fall below the 21,000 level. People can buy dollars cheaper in gold shops than in banks.
- **With an inflow of remittances over Tet** and a falling of the trade deficit to a mere USD100 mn in January, prospects for the VND look favorable. No more discussion is heard of any devaluation either in early 2012 or later in the year.
- **The BOP is expected to run a surplus of USD3 mn** for a second year in a row, thus beefing up SBV's holdings of foreign reserves. The SBV governor publicly declared a pledge to hold any depreciation in VND value for this year to 3%. After his success over keeping a loss in VND to 1% during Q4 of last year, his new commitment is greeted with much less skepticism.
- **The SBV set a target of credit growth of 15-17% for the year.** But each bank will be allocated a specific limit depending on its financial strength. Thus as Q1 unfolds, banks are waiting to hear from the SBV about its loan book growth target. This is an important parameter because revenues from lending operations still account for 60-70% of bank earnings.

VinaCapital
Sun Wah Tower
115 Nguyen Hue, District 1
Ho Chi Minh City, Vietnam

Equity market: Market in hibernation. A new index was introduced.

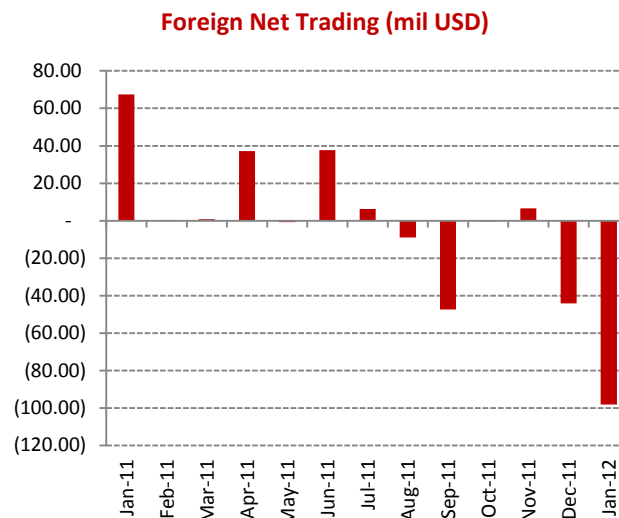
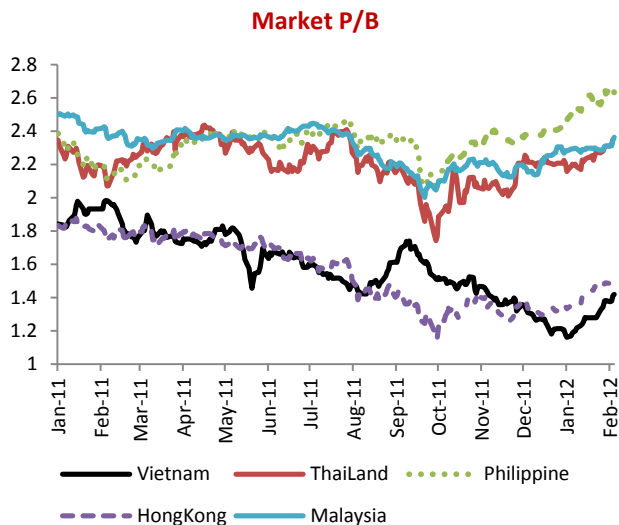
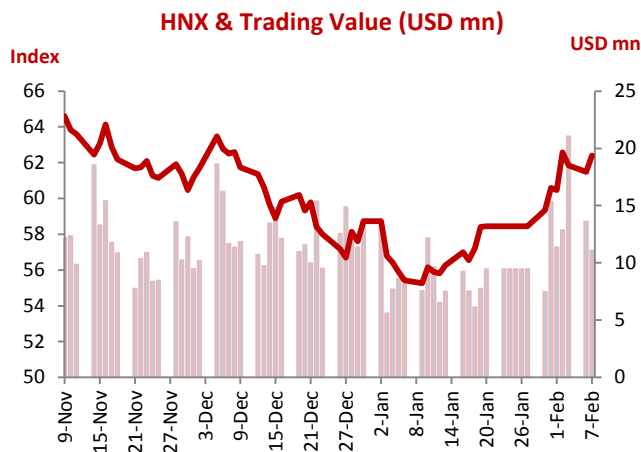
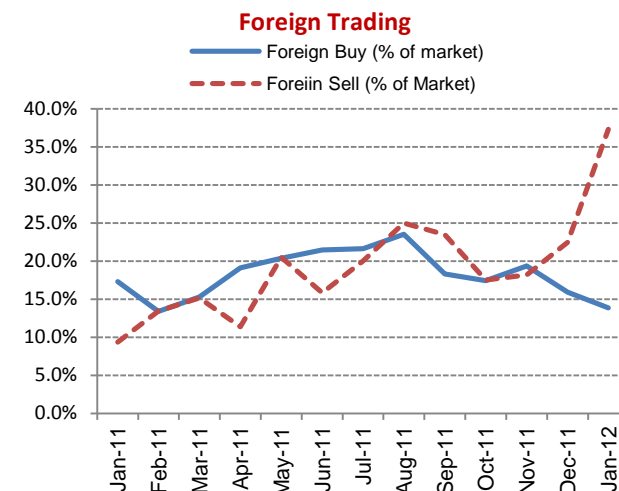
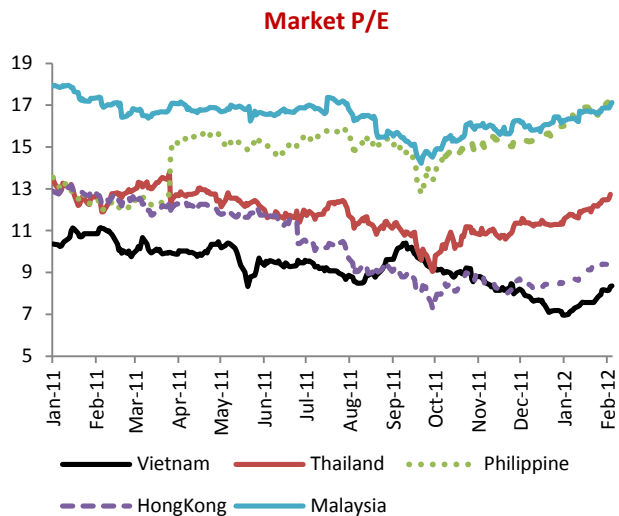
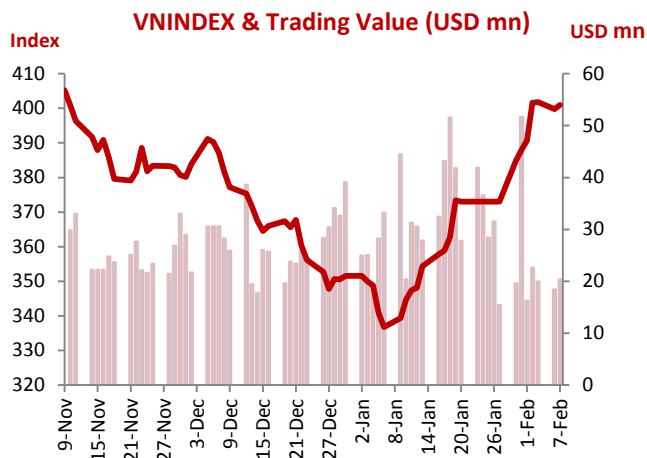
- **The market was inactive in January due to a long holiday.** Liquidity was down 60% because almost everybody was away. However, the VNI gained 10.3% on the strength of financial stocks.
- **The VN30 index (composed of 30 large stocks, with a free float adjustment)** stirred some market interest. It may lead to a market indexing strategy. But it is still too early to tell.

Fixed income market: Bank liquidity is worsened by Tet withdraws.

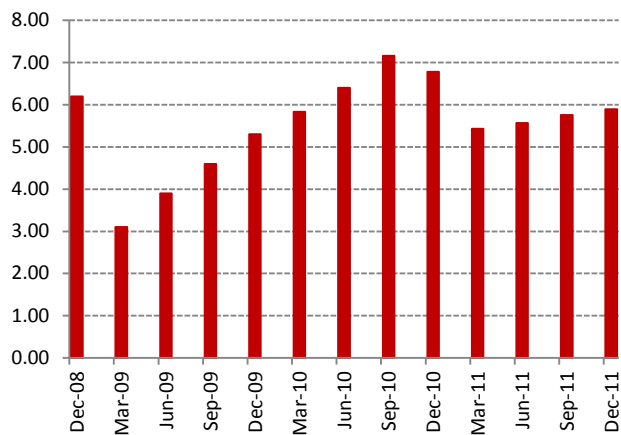
- Knowing that bank liquidity is made worse by a seasonality factor: the large withdraws of cash by people for spending and gift giving over Tet, the SBV readily injected funds via the OMO market. However, it keeps the maturity of its repos at 7 and 14 days only. No such funds can be used for lending operations and impacting on inflation.
- True to form, the SBV went back into the market and began withdrawing liquidity right after the holidays, thus neutralizing its own previous injections.

FX market: Confidence in SBV policy calms market.

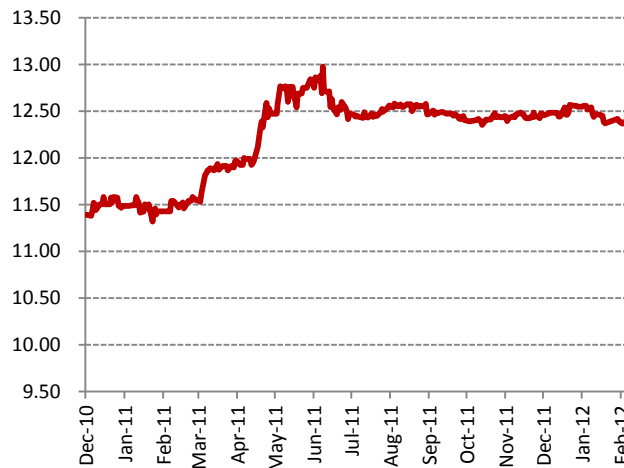
- **The FX market in January was calm and composed**, with none of the tensions and panic of previous years.
- **People and markets have confidence that the central bank can manage the USD/VND rate.** A surprising drop in the trade deficit and a projected BOP surplus for 2012 added to a sense of stability in the VND value. The FX risk is now at a low ebb.



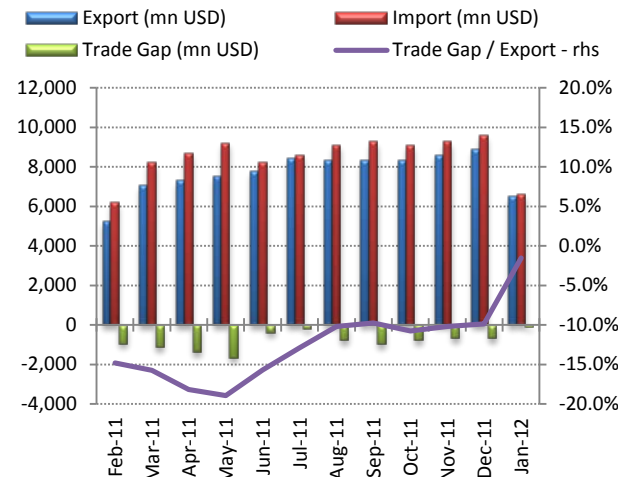
YTD GDP Growth (% YOY)



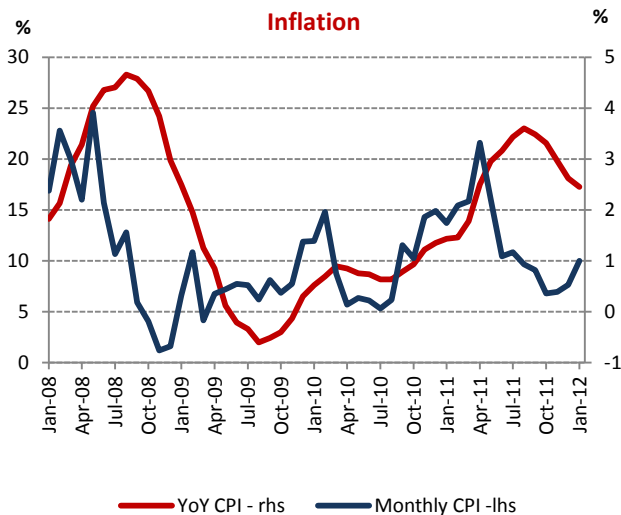
Rate on 5-Year VGB



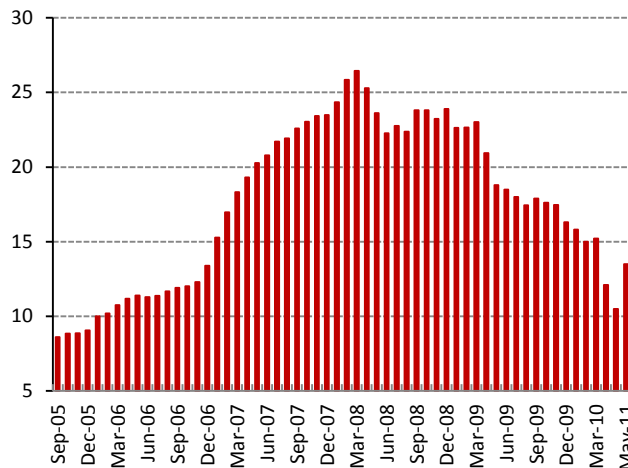
Trade Balance



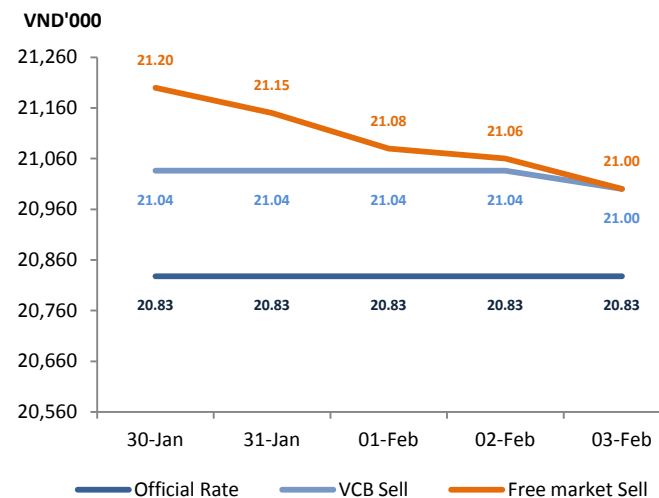
Inflation



FX Reserves of SBV (in billion USD)



VND per USD



Outlook for the economy

Looking forward for the year, or at least the next 2 quarters, prospects for the economy are favorable. It does not mean, as we hasten to add, that there are no problems that must be addressed. But they are not likely to damage the steady progress being made.

All major indicators (GDP growth, inflation, exchange rates) are heading in the right directions. And the Resolution 11 provides an overall framework within which more progress can be made. This year, Tet season comes early then passes away quietly, without a feeling of crisis or tensions that tend to pervade the economy at the end of year. Foreign analysts are fairly quiet about their forecasts for a new year devaluation as in the past. In fact, none of them now forecast a devaluation at all during this year. They seem to have confused a devaluation with a depreciation. The VND would lose some value v. the USD, but at a steady, gradual rate over the year. With a crawling-peg policy, there is no need for a devaluation if it is implemented right. This policy has been in place now for a full year (Feb 2011 – Feb 2012) and has proven effective in avoiding FX crises. We have reminded occasionally that the policy has 2 parts (the pegging and crawling). They must be operated together to bring about stability.

- **GDP growth has now become a boring subject** because its moderate pace has been baked into the policy cake since Feb last year. It would deliver a sub-par performance (compared to the previous decade, fluctuating around a mean rate of 6.0%, give or take. The government still sets a stretching goal of attaining 6.5% if conditions are favorable. We think this caveat of “favorable conditions” are a smart way to hedge one’s bets.
- **Inflation would continue to trend down** because of a lagged effect of tight monetary policy and will stay on this trajectory unless the policy changes. Some wiggles may happen along the way as prices of foods fluctuate, or a hike in costs of utilities (electricity, gasoline). Such exogenous forces tend to be political factors (especially the policy of de-subsidization) and are beyond the control of economic policy makers. The state goal of getting to single digit inflation by end year is commendable, and may well be feasible. We think that a CPI rate around 10% or slightly higher is an acceptable achievement.
- **The one bright spot on Vietnam’s economic landscape remains on course:** the VND has held its own vis a vis the USD during and after the Tet holidays. The reference rate is fixed at 20,828 for many weeks now, implying an upper band rate of 21,036. In recent days, the free market rate has dropped below 21,000 : people now can buy dollars at a lower price from a gold shop than from a bank.

We would be remiss if we do not mention some of the difficult issues remaining to be addressed.

- **Interest rates remain high**, with business loans costing 19-20% per year. Such a situation is very harmful for the production activities of many companies, especially the small and medium ones. They have direct access to capital markets (either stock or bond) and have to rely on bank loans even for working capital, to say nothing of capex funds for investment purposes.

- **Bank liquidity poses a serious problem** and needs to be resolved in Q1 if possible. It is commonly agreed that a large amount of bank capital is now locked up in uncollectible RE loans. As long as this sector is frozen, that pool of liquidity cannot be extricated.
- In recent days, it has come to light **that the interbank market is now part of the liquidity blockage**. This comes as a surprise because market 2 (as it is usually known, as versus market 1 of customer deposits) is supposed to be a place to seek liquidity when other avenues become unavailable. The size of this market is significant, estimated at 500,000 billion VND of loans outstanding.
- **The problem began late last year when many interbank loans become uncollectible** like those in RE. Loans on this market are made without collateral because of a pledge by the SBV to provide a guarantee. After some loans became sticky, lenders begin to request collateral in form of gold, VGB, FX. A risk premium is added on top of the regular loan rates, and many lenders begin to ration the loan amounts and the choice of counterparties. After the collapse of Lehman Brothers, the commercial paper market seized up, causing a threat of worldwide financial collapse. A freezing of the interbank market would be equally damaging for Vietnam because a CP market has yet to develop here, and the interbank market is an important channel of liquidity.
- **The liquidity problem can only be resolved** with a re-structuring of the banking system. The SBV has a road map for this purpose. Its implementation is proceeding, albeit slowly.

Bottom line:

- **Prospects for the economy are favorable**, and are on track for further improvement.
- The people and the markets can see with some clarity where things are heading, and what government policies are taking them there.
- **With declining inflation and interest, capital markets** (stock as well as bond) would likely pick up in the second half. Since FX risk is now at a low, foreign investors have incentive to disburse in H1, and stay in position for a recovery later in the year.
- **The most important change this year** is some return of confidence among the people as expressed by their holding the VND and keeping its value stable. There is a feeling that policy makers are in control of the economy, and are addressing its problems as appropriate.

Period	2009A	2010A	2Q-11A	3Q-11A	2011A	2012E
Real GDP Growth (YoY)	5.3%	6.8%	5.57%	5.76%	5.89%	6.00%
CPI Growth (YoY)	6.52%	11.75%	20.82%	22.42%	18.1%	12.0%
Refinancing Rate	8.0%	9.0%	14.0%	14.0%	15.0%	13.0%
VND/USD (Spot)	18,479	19,500	20,620	20,834	21,036	22,500

Basic Forecasts

GDP

January started the year with a weak economic performance: Industrial production declined 2.4% YOY. But the main reason is a seasonality factor: there were only 16 working days for plants and factories in this month of Tet holidays. The production rate will pick up in later months when the work tempo returns to normal. However, a moderating trend in economic growth has been set since early 2011 with an austerity policy. Even during Tet, retail sales were weaker than previous years because consumers' purchasing power has been eroded by inflation. High lending rates also hamper production activities of many businesses. The public investment component of GDP is subject to more constraint this year as fiscal tightening continues. Private investment is already scaled back due to high COF (cost of funds) and a lack of strong effective demand. All signs point to a year of sub-par growth. The government set a target of 6.0 – 6.5 % increase in GDP. Most analysts consider this goal rather optimistic, and most forecasts cluster around 5.5% to 6.0%.

VCG maintains a GDP growth projection of 6.0% for this year, a bit higher than the 5.9% achieved last year.

CPI

CPI for January rose 1.0% MOM, equivalent to 17.3% YOY. This favorable result can be attributed to a moderation in prices of foodstuffs due to adequate supplies from the agriculture sector. The prices of foods (either served at home or eating out in restaurants) still climbed slightly because January is a holiday month after all. A major price stabilization program was put in place prior to the Tet shopping season. Most staple consumer commodities are included (rice, cooking oil, sugar, gas) and the impact was helpful in keeping their prices in check. Going forward for this year, one uncertain element is the rate of de-subsidization in prices of electricity, gasolines. The power monopoly EVN is in financial difficulties, and may request more frequent price adjustments. The government has declared a cap of 10% on electricity rates, spread out during the year. Overall, we expect the declining trend in inflation to be maintained, barring some unexpected surge in world commodity prices, especially of oil due to an unstable situation in oil-producing regions of the Mid-East.

VCG maintains a projected gradual moderation in inflation , ending the year at 10 – 12%.

FX

January saw a continuing stability in the VND value. There was none of the tensions and crisis feeling associated with the end year period of some previous years. The SBV governor successfully redeemed his pledge to keep any VND depreciation in Q4 to 1%. This has a psychological effect in boosting confidence in the people that the central bank has the FX situation under control. The Tet month was also a peak period for remittances to become available due to the home visits of many overseas Vietnamese. Due to a significant differential of deposit rates in VND and USD, most of those remittances were converted into the dong as a form of carry-trade. The BOP for last year ended with a surplus of USD2.5 bn , and early forecasts for this year point to another surplus of about USD3.0 bn. Consequently, foreign reserves of the SBV would continue to improve from a level of USD15.2 bn last year. FX management by the central bank has been a mark of success, and no devaluation has been mentioned by analysts (domestic and foreign).

VCG maintains a projected interbank exchange rate of 22,500 for end of this year.

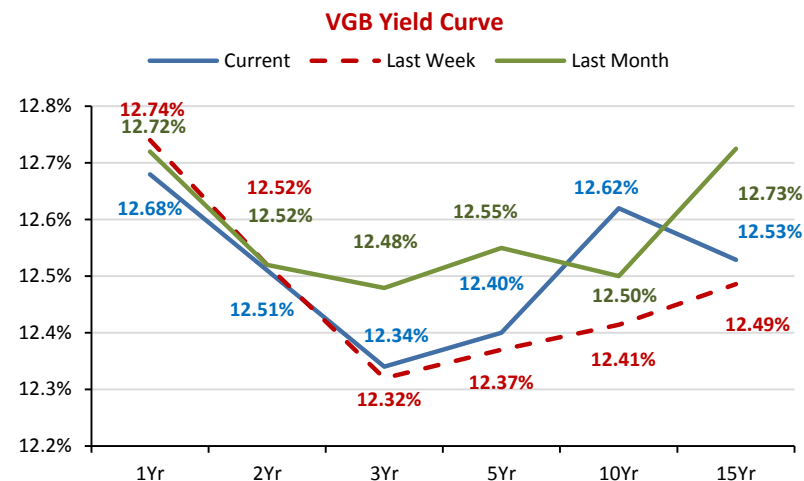
Market Outlook

Equity

- Vietnam stock market was quite calm in Jan 2012 with the lack of positive news and most of investors stayed sideline waiting for opportunities in new Lunar Year. The low liquidity therefore is a certain result. Trading activities has declined substantially, down 60% compare to last year-end month. Though, the VNINDEX was able to posted a 10.3% gain, finished the month at 387.97 pts.
- Foreign investors has become the most active players on the market in both side. They sold out a remarkable value of stock of USD150 mn, especially in STB and VIC (ANZ has divested all of their stake in STB of around 103 million shares). Meanwhile, foreign investor bought in around USD50 mn, mostly in FPT, resulting a net selling of USD100 mn in January 2012.
- The new VN30 index (which include 30 largest market-value stock with an free float adjustment) and its constituted stocks were the market's attention . This is an brand new index in the purpose to reflect precise market performance and avoid the distortion from the index effect of some largest market-value stock. There was new investment trend that to purchase these stocks in the new index basket. However, it's not sure that how long this short-term trend can extent.
- The market outlook in 1H.2012 is still unclear, as many observers predicted, while investors are adverse to take risk given current difficult macro situation: high interest rate along with high inflation; banking liquidity and some fluctuations caused by the SBV's bank re-structure program.
- Vietnam market is rather attractive in term of market multiple: P/E and P/B ratio are stable at 8.3x and 1.4x. However, it's soon for short-term investor to go out the Street. Market watching with cautious eye is necessary in this circumstance.

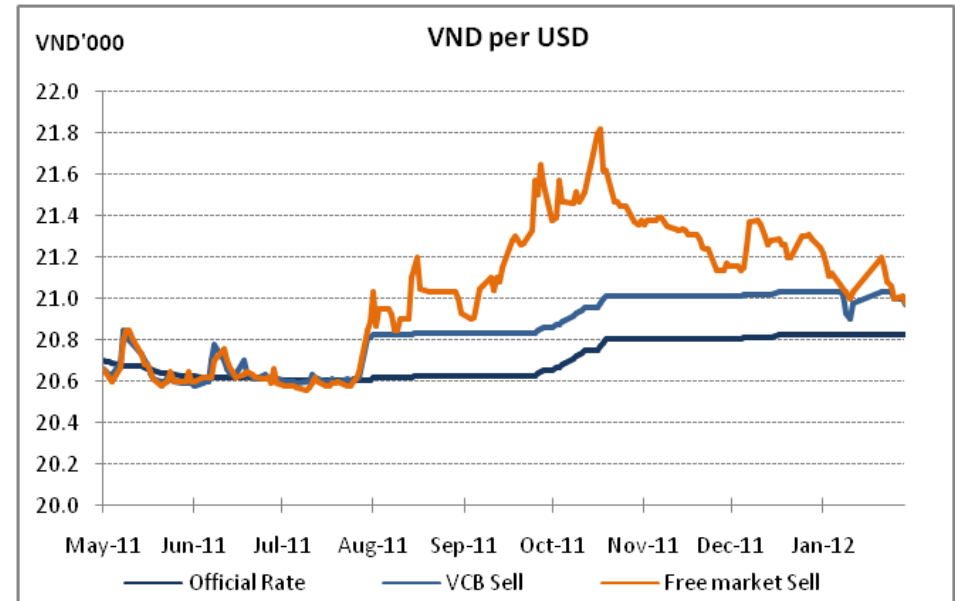
Fixed income

- **In January, liquidity at most banks are squeezed, not only because of uncollectible loans**, but also due to a large withdraw of cash by customers for holiday spending, gift giving.
- **In spite of SBV efforts to inject funds via the OMO market** to relieve this seasonal liquidity pressure, most banks hold on to their cash reserves . they have very few idle funds on hand to participate in bond sales. The prices of bonds decline and the yield curves shift up a bit during this period.
- **The central bank was prominently present in OMO activities.** The extra need for funds by banks are of a seasonal reason and would abate after the holidays are over. Any injections are of short maturity (7 to 14 days) and cannot be used for credit expansion. Inflationary impact on the economy can be removed by OMO withdraws when the repos are allowed to mature without being renewed.



Foreign exchange

- **Over the Tet month of January, the FX market was remarkably calm and composed.** Dollar supply, augmented by remittance inflows from overseas Vietnamese, kept the market in balance.
- **The reference rate was maintained at 20,828 during this whole period.** Many banks sell dollars below the upper band ceiling for the first time in months. Free market rates occasionally fell below the 21,000 level, implying that supply of dollars are adequate to meet demands.
- World gold price was subdued as the dollar strengthened after some positive economic statistics were released by the Fed. The euro debt crisis were dampened by a bold plan of the ECB: making unlimited loans to commercial banks with a 3 year maturity and a low interest rate of 1%. Banks can turn around and buy sovereign bonds at 5 – 6%, earning a significant profit margin.
- **The SBV handling of its FX policy has been a success,** and leaves the markets with a feeling that no crisis is forthcoming. FX risk is at a low ebb.



VinaCapital

Don Lam Chief Executive Officer

Brook Taylor Chief Operating Officer

Andy Ho Managing Director, VOF

David Henry Managing Director, VNL

Tony Hsun Managing Director, VNI

Alan Pham Chief Economist

Contacts

David Dropsey Investor Relations/Communications
ir@vinacapital.com
+848-3821-9930
www.vinacapital.com

Huong Nguyen Public Relations Director
huong.nguyen@vinacapital.com
+848-3821-9930
www.vinacapital.com

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