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Vietnam

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2011 ended on a note of stability. Further improvement seen in 2012.

- **The past year recorded 2 satisfactory results** i) GDP growth at 5.9% and ii) unofficial USD rate at 21,300, and one work in progress: iii) inflation at 18.1 % YOY. Our projections are pretty close to the mark: 5.8% for GDP, 21,500 for exchange rate, and 18.0% for inflation. They are all within an acceptable 3% margin of error.
- **Liquidity at many banks becomes urgent, as shown by symptoms:** i) return of negotiated deposit rates, up to 21%; ii) tensions on the interbank market; iii) the SBV net injected funds through OMO, raising its repo maturity to 21 days.
- **Shortage of liquidity is linked to a frozen Real Estate market** where loans cannot be repaid due to slow-moving merchandise. Price cutting for luxury apartments is spreading but relief is not in sight.
- **One bright spot was the FX policy:** i) a decisive switch by SBV to a crawling-peg regime in Feb; ii) flexible adjustment of the reference rate throughout the year; iii) sale of dollars by major SOE into the market. The gray market rate stays within 1-2% of the upper band, a signal of VND stability.
- **The BOP was estimated to be in surplus** (for first time in years) of ~ USD3 bn, supported by : i) a declining trade deficit (about USD10 bn); ii)surging remittances (USD9 bn); iii) stable FDI disbursements (USD11 bn). The capital account of Vietnam's BOP is in surplus, and can more than compensate for a current account deficit. All warnings about a BOP crisis and devaluation at year end did not happen.
- **Inflation peaked at 23% in August and began trending down to end year**. Resolution 11 is declared to be effective into the new year and would help alleviate inflation pressures. In spite of skepticism from many quarters, domestic and foreign, the political will for implementation did exist after all. It is expected to continue into the future.
- **FDI flows changed direction** away from Real Estate into manufacturing and services. This is a good development, creating many secondary effects on other sectors of the economy.
- **The de-subsidization of utility prices will continue** but at a more measured pace, with an eye on inflation control: electricity prices will rise 5-10% in 2012, versus 15% last year.
- **Banking reforms will be accelerated** after a successful first merger of 3 banks. The SBV laid out a roadmap for the program, with a goal of streamlining the system by end 2013. Banks are now classified into 4 categories, with grades from A to D (strong to near failing), and credit growth limit allocated accordingly.
- **At end year 2011**, actual results show that growth in M2 and bank credit was at 10% and 12%, respectively. This is quite a drastic slowdown from a rate of ~ 40% in recent years. There is some problem in monetary policy execution: the initial goals for both were set at 18% and 16% early in 2011. But actual results fall far short. **Such a strong reduction is in money supply and credit** is partly responsible for high interest rates, and a severe liquidity squeeze towards the end of last year.

Equity market: The down phase continues. Most investors stand on the sidelines.

- **The VNI lost 7.6% in December.** Market mood is downbeat with few positive macro news and a lot of rumors that raised investors' level of uncertainty.
- **It is an environment where most speculators have left the market** to cut losses, leaving a group of patient investors hanging on.
- **Foreign investors turned net sellers,** with most of them trying to position the yearend financial statements and improving their NAV to the extent possible.

Fixed income market: Bond market suffers from tight liquidity: Yield curves shift up.

- **With a liquidity shortage in the banking system, there was less enthusiasm to bid for government bonds.** Most banks are in a defensive position, husbanding their cash reserves to meet customer withdraws for holiday spending.
- **The SBV stepped up its injections of funds through the OMO**, considering this a normal response to a seasonal spike in currency demand. The composition of M1 (M1 = C + DD) may shift around (between C and DD), but the basic money supply would not increase on a net basis.

FX market: Stability on FX market. No sense of panic as in previous years.

- **There was remarkable calm and stability on FX market, as compared to the sense of tension and panic in previous years.** All usual demands for dollars (to repay FX loans, to import or smuggle gold) have **been anticipated by the SBV** due to their seasonal character, and steps taken to neutralize them.
- **SBV feels confident that it has sufficient FX reserves to meet popular demands.** It maintained a reference rate of 20,828 towards year end and redeemed a pledge to keep VND loss in value to 1% in Q4. In the event, it **used up 97 basis points of that pledge, leaving only 3 bps on the table**.
- **Prospects for FX in 2012 are favorable**, judging from the skill that SBV managed its exchange rate policy in 2011.

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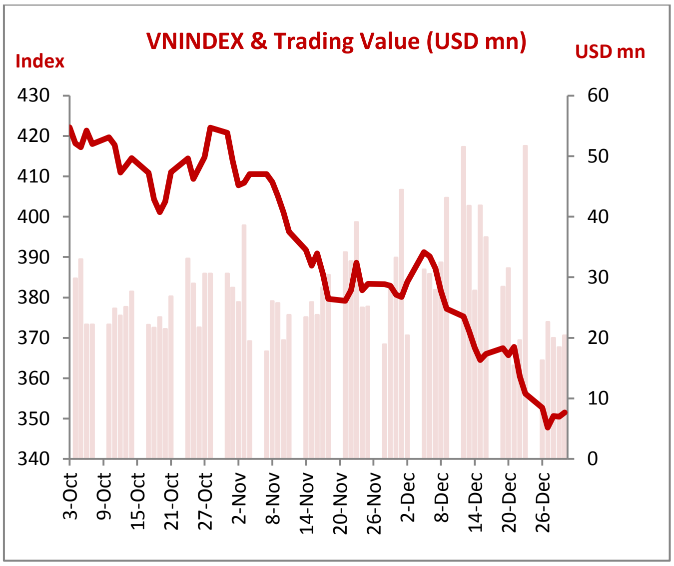
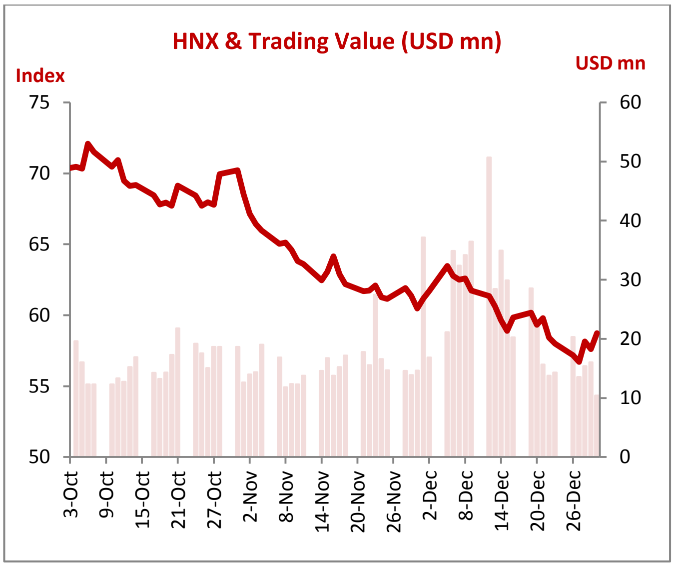
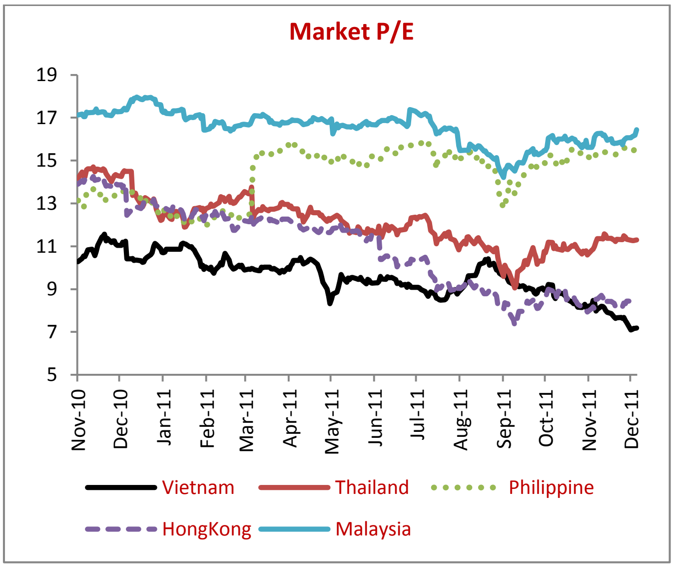
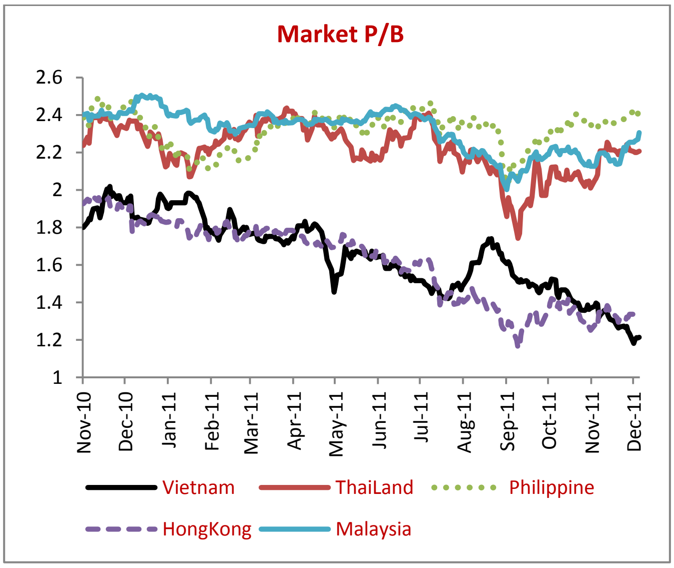
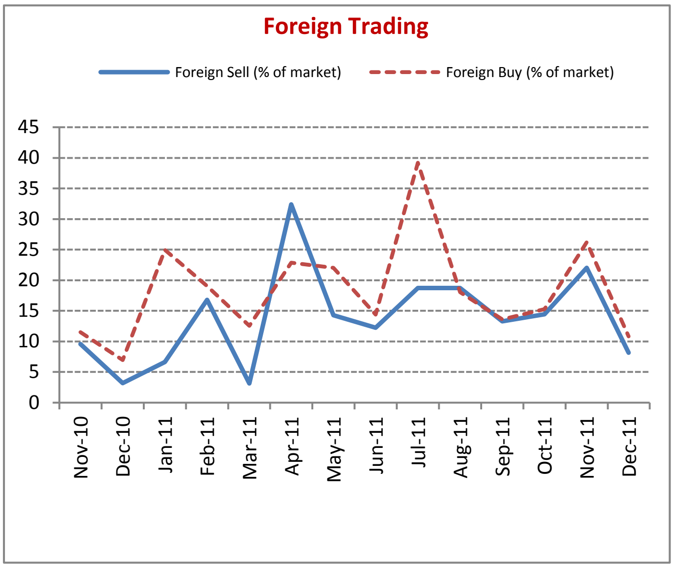
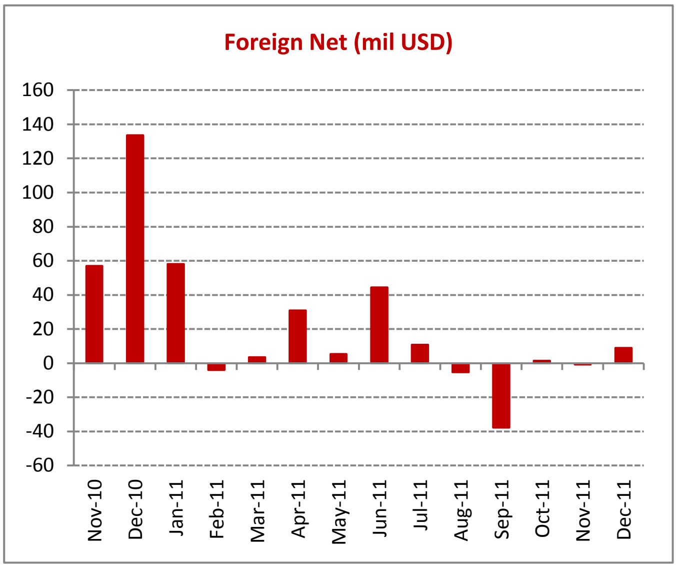

VNINDEX & Trading Value (USD mn)
Index
USD mn
430
420
410
400
390
380
370
360
350
340
60
50
40
30
20
10
0
3-Oct
9-Oct
15-Oct
21-Oct
27-Oct
2-Nov
8-Nov
14-Nov
20-Nov
26-Nov
2-Dec
8-Dec
14-Dec
20-Dec
26-Dec

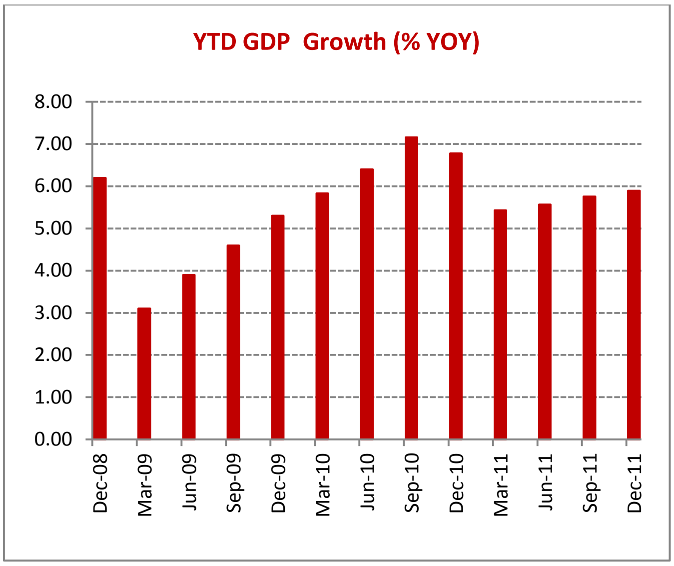

HNX & Trading Value (USD mn)
Index
USD mn
75
70
65
60
55
50
60
50
40
30
20
10
0
3-Oct
9-Oct
15-Oct
21-Oct
27-Oct
2-Nov
8-Nov
14-Nov
20-Nov
26-Nov
2-Dec
8-Dec
14-Dec
20-Dec
26-Dec

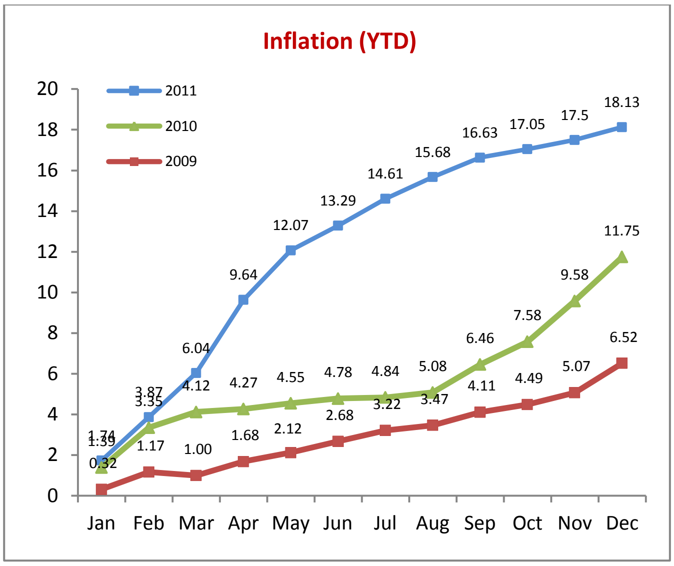

Market P/E
19
17
15
13
11
9
7
5
Nov-10
Dec-10
Jan-11
Feb-11
Mar-11
Apr-11
May-11
Jun-11
Jul-11
Aug-11
Sep-11
Oct-11
Nov-11
Dec-11
Vietnam
Thailand
Philippine
HongKong
Malaysia

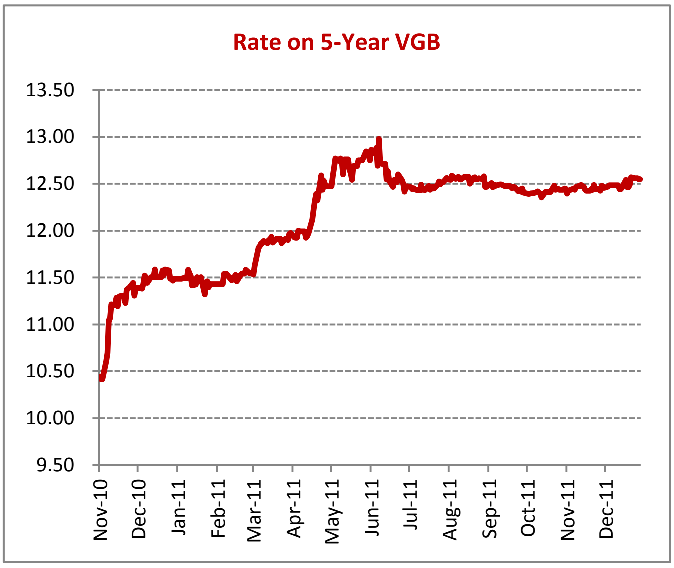

Market P/B
2.6
2.4
2.2
2
1.8
1.6
1.4
1.2
1
Nov-10
Dec-10
Jan-11
Feb-11
Mar-11
Apr-11
May-11
Jun-11
Jul-11
Aug-11
Sep-11
Oct-11
Nov-11
Dec-11
Vietnam
ThaiLand
Philippine
HongKong
Malaysia

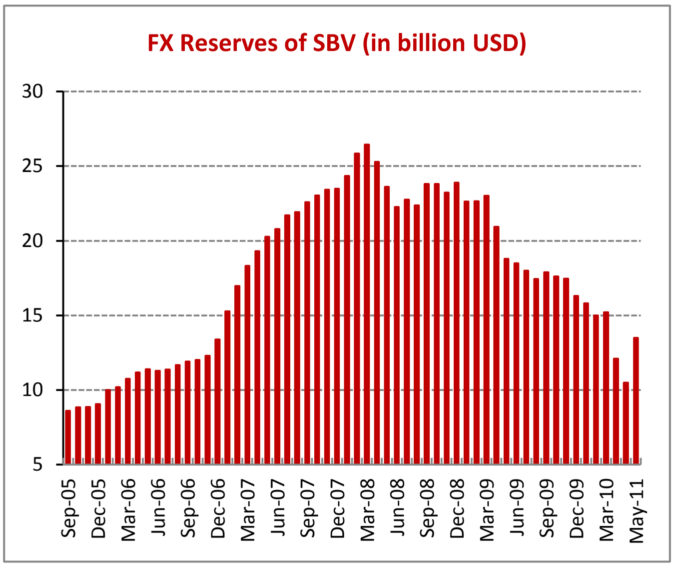

Foreign Trading
Foreign Sell (% of market)
Foreign Buy (% of market)
45
40
35
30
25
20
15
10
5
0
Nov-10
Dec-10
Jan-11
Feb-11
Mar-11
Apr-11
May-11
Jun-11
Jul-11
Aug-11
Sep-11
Oct-11
Nov-11
Dec-11

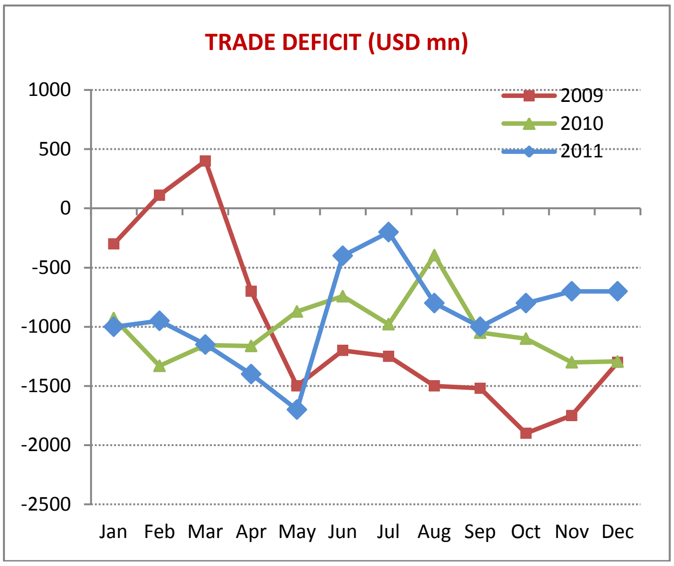

Foreign Net (mil USD)
160
140
120
100
80
60
40
20
0
-20
-40
-60
Nov-10
Dec-10
Jan-11
Feb-11
Mar-11
Apr-11
May-11
Jun-11
Jul-11
Aug-11
Sep-11
Oct-11
Nov-11
Dec-11

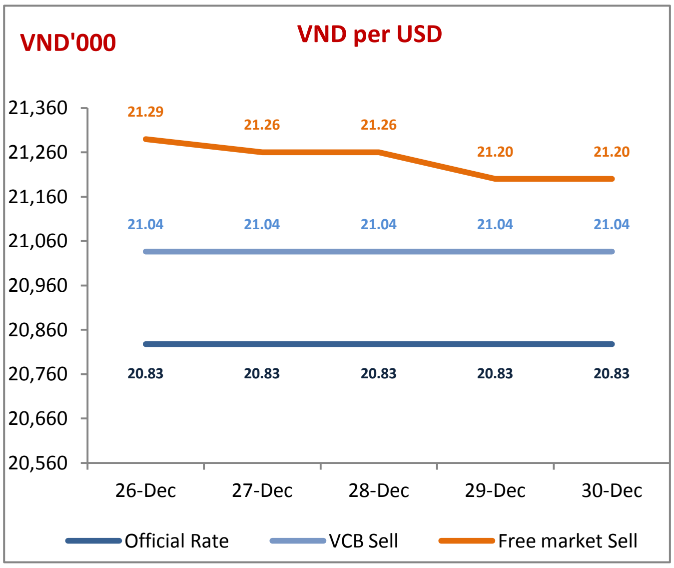

YTD GDP Growth (% YOY)
8.00
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
Dec-08
Mar-09
Jun-09
Sep-09
Dec-09
Mar-10
Jun-10
Sep-10
Dec-10
Mar-11
Jun-11
Sep-11
Dec-11


Inflation (YTD)
2011
2010
2009
18.13
17.5
17.05
16.63
15.68
14.61
13.29
12.07
9.64
6.04
3.87
1.74
11.75
9.58
7.58
6.46
5.08
4.84
4.78
4.55
4.27
4.12
3.35
1.39
6.52
5.07
4.49
4.11
3.47
3.22
2.68
2.12
1.68
1.00
1.17
0.32
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec


Rate on 5-Year VGB
13.50
13.00
12.50
12.00
11.50
11.00
10.50
10.00
9.50
Nov-10
Dec-10
Jan-11
Feb-11
Mar-11
Apr-11
May-11
Jun-11
Jul-11
Aug-11
Sep-11
Oct-11
Nov-11
Dec-11


FX Reserves of SBV (in billion USD)
30
25
20
15
10
5
Sep-05
Dec-05
Mar-06
Jun-06
Sep-06
Dec-06
Mar-07
Jun-07
Sep-07
Dec-07
Mar-08
Jun-08
Sep-08
Dec-08
Mar-09
Jun-09
Sep-09
Dec-09
Mar-10
May-11


TRADE DEFICIT (USD mn)
2009
2010
2011
1000
500
0
-500
-1000
-1500
-2000
-2500
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec


VND'000
VND per USD
21.29
21.26
21.26
21.20
21.20
21.04
21.04
21.04
21.04
21.04
20.83
20.83
20.83
20.83
20.83
21,360
21,260
21,160
21,060
20,960
20,860
20,760
20,660
20,560
26-Dec
27-Dec
28-Dec
29-Dec
30-Dec
Official Rate
VCB Sell
Free market Sell

OUTLOOK FOR THE ECONOMY

As mentioned, **2011 ended with satisfactory results for GDP growth and FX stability**. Government policy in these 2 areas were conducted with competence and efficiency**. Inflation remains an unfinished business** because: at 18.1% YOY, Vietnam ranks highest in Asia in price pressures.

As we look forward, **2012 is shaping up as a period of moderate economic growth and further improvement in stability.** All major indicators (inflation, GDP, exchange rate) are heading in the right direction. With a government declaration that its austerity program is kept in place, we are very hopeful that the improvement will be maintained. 2011 was a challenging year and at times, the political will to stick with it was called into question. But those doubts turned out to be unfounded.

A review of government benchmarks for 2012 encourages us that a tight policy framework will not be loosened any time soon.

- **Growth of bank credit will be kept in a narrow range of 15% - 17%,** applicable to the whole system. One new policy element is introduced: each bank will be assigned a loan book growth rate consistent with its financial ability and strength. This is designed to remedy a flaw of setting up an uniform credit growth target for all banks as if they are created equal. In fact they are not. In Q4, with popular consumption and business activity picking up, the large banks still have room for lending, but many medium and small banks run into liquidity shortage. They end up breaching the 14% deposit cap in order to attract customers. The SBV also has to inject large amounts of OMO channels, and raises the maturity of repo contracts to 21 days.

- **GDP growth is set at 6.0% with a possibility to attain 6.5%** if economic conditions are favorable. This is a moderate goal and is well below the 7.1% growth rate achieved over the decade of 2000-2011. There has been no objection in government circles about the impact of low growth on social stability, as had happened in the past. This indicates an official degree of consensus that stability should now have priority. With the 2 main drivers (retail sales, industrial production) operating at normal capacity, this goal is achievable. This range of economic expansion (5.8% – 6.0%) is considered a sustainable pace without putting under pressures on price levels.

- T**he government is aware that its original inflation goal (set at 7% in early 2011) w**as not attained due to pressures from excessive credit growth in previous years. But with the tight monetary policy being maintained, it is possible, though not probable, that a single digit CPI increase for 2012 is feasible. However, most observers would consider a rate **slightly above 10% quite satisfactory**, and laying the groundwork for a single digit in early 2013.

- T**he government is determined to push on with a comprehensive financial re-structurin**g. The main stumbling block here is a serious lack of liquidity in the banking sector. Many banks loans to (i) RE companies and ii) loss-making SOE's) have become uncollectible. These bad assets are mostly on the book of medium and small-size joint stock banks. In a real sense, the health of all 3 sectors (banking, RE, SOE) is closely connected. Any successful re-structuring program would likely have to involve actions on all 3 fronts.

Bottom line:

- **2011 was a difficult year with many intractable economic problems**. It has been compared to 2008 as a challenge to policy makers.
- Rising to the occasion, the **GVN introduced a comprehensive reform program** which was then seriously implemented. By end year, the stabilization process is by no means completed. But significant progress has been made, and the roadmap is clear for further improvement.
- **Many observers, foreign and domestic, were skeptical in the past** about reform programs, due to a lack of policy determination in staying the course. However, that missing ingredient was present in 2011, and likely to be there in 2012 as well.

BASIC FORECASTS

GDP

Even though GDP growth for Q4 attained 6.4% as compared to 5.8% for H1-11, it cannot change a moderating trend that was set early in the year by the adoption of an austerity program. Therefore, GDP growth for 2011 ended at 5.9% (very near our projection of 5.8%). Most businesses feel the impact of high interest cost and lack of capital funding. Their activities showed some upturn in Q4 because this is a major selling season for many enterprises. Retail sales picked up in spite of inflation holding down consumers purchasing power: some inventories were cleared out at price reductions, and many families dip into savings to keep up spending during holidays. We expect a trend in moderate economic growth to persist as an expression of government policy. Macro stability is considered as a priority objective. Fiscal restraint was not rigorously implemented last year due to objections from many provincial authorities. But a stronger budgetary discipline will now come into place and provide further reduction in total demand of society. **VCG projects a GDP growth of 6.0% for this year, slightly higher than the 5.9% recorded for 2011.**

CPI

Inflation in December came in at 0.53% MOM , equivalent to 18.1% YOY. This is quite close to our projection of 18.0%, and reflected a moderation of prices in major groups of the CPI basket (foods, fuels, construction). The CPI has maintained a downward trend since reaching 23% YOY in August: a delayed reaction to the tightening of policy initiated in February. Prospects are favorable for this improving trend to continue into 2012: i) Resolution 11 is officially declared to be kept in place; ii) the program of de-subsidization in utilities prices (electricity, gas, fuels) would go on but at a more measured pace. In mid-2011, a sudden increase in prices of power and gasolines (by 15% and 30%, respectively) cause a large jump in the CPI and led to concerns of a resurgent inflation. In January 2012, price hikes are expected across a wide range of goods and services as holiday season shopping gets into high gear. However, the Prime Minister has instructed major cities and provinces to set up price-stabilization programs on a larger scale than last year. First signs of success indicate that **shoppers are seeing stable prices of most staple commodities**. Tet will come early this year (on January 23, 2012) and most price pressures on consumer goods would tend to dissipate by early February**. VCG projects a gradual easing of inflation throughout this year, and end-year inflation is expected to be 10-12%.**

FX

December 2011 was a month of remarkable stability for the FX market, in marked contrast to a similar month in 2010 when the VND came under great pressures. All of the supposed bad news for FX at end year were widely reported: i) search for dollars to make repayment on FX loans contracted during the year; ii) demand for USD to import gold for speculative purpose; iii) higher need for FX to pay for imports of holiday-related merchandise. The surprising thing is that none of these sources of pressures seemed to materialize. The SBV raised its reference rate to 20,828 , equivalent to an upper band ceiling of 21,036. The gray market rate was hovering about 21,300. Our projection of 21,500 for end 2011 turned out to be more pessimistic than reality, though the differential of VND200 was less than 1%. SBV

Governor Binh won his bet to keep any loss of value in the dong in Q4 to 1%, even though he used up 97% of that limit, leaving only 3 basis points on the table. It is an achievement for the SBV to manage the USD/VND relationship in an effective manner during 2011. The governor was named Man of the Year by several financial publications in Vietnam in recognition of his FX leadership**. VCG projects an interbank exchange rate of 22,500 at end 2012.**

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

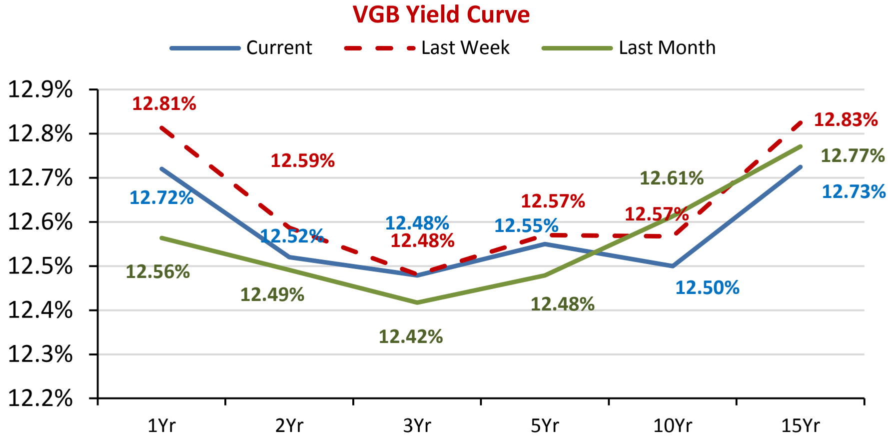
MARKET OUTLOOK

Equity

- **The VNI dropped again in December**, prolonging a 3 month losing streak, ending the month at 351.5 pts, or a loss of 7.6%. Market mood was downbeat with few positive news and a lot of rumours (for ex: some securities firms close to failing, a large capital withdraw by foreign funds in 2012).
- **With a lot of selling by discouraged investors**, market liquidity improved as compared to the previous month: trading volume and value rose 31% and 21%, respectively. It was a time when most speculators decided to cut losses by exiting the market, leaving a group of patient investors hanging on.
- Foreign investors turned net sellers to the tune of -USD44.2, with most of them trying to position for the year-end financial statements, and improving their NAV to the extent possible.
- Vietnam's market's P/E and P/B were at 7.1x and 1.2x, respectively, making it quite competitive compared to neighbouring bourses.
- **Any improvement in market psychology would have to wait for H2-12**. During the first half year, there are these impediments to an upturn:
  - Inflation is still high though on a downtrend, possibly falling to 14% by midyear.
  - Many investors are exhausted by a trying year, and welcome a chance to take time off for the holidays.
  - Liquidity problems at banks are being addressed, but clear results are slow in becoming visible.

Fixed income

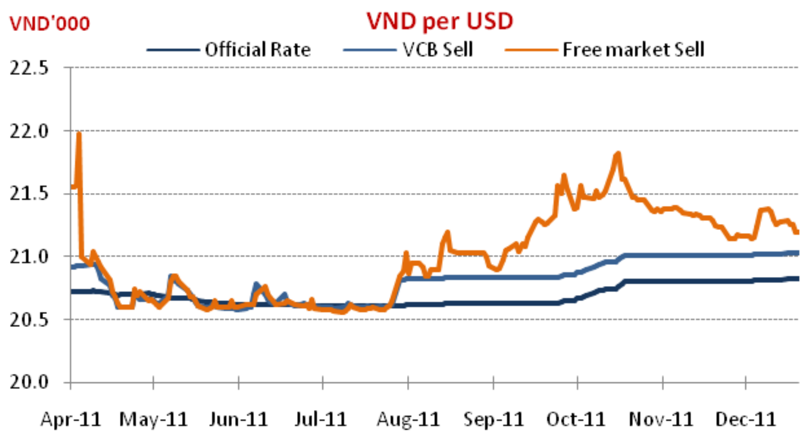
- **Due to a liquidity squeeze, activities were subdued on the primary market**. Most banks husband their cash reserves. Furthermore, towards yearend, customers withdraw currency from their accounts for spending and giving gifts, worsening the cash shortage.
- Bank participation in bond auctions declined, causing a fall in bond prices, and the yield curves shifted up.
- **The secondary market as quiet as well**, partly due to the holiday season. Trading volume declined substantially. Most trades were repo transactions, not outright sales or purchases.
- **The SBV was visibly present on the OMO market**, injecting funds in net terms to alleviate cash demand from the people and a liquidity squeeze on banks. SBV feels that it should respond to a seasonal spike in currency demand. There is no net increase in M1 due to its action: as we know, $M1 = C + DD$, and the composition of M1 is shifting around without raising the overall volume of money supply.



Source: Bloomberg as of Dec 30th, 2011

Foreign exchange

- **There was stability on FX market in December** in contrast to tensions felt at the same period in previous years. The SBV maintained a reference rate of 20,828 or equivalent to an upper band ceiling of 21,036. The gray market was hovering about 21,300 by end year, as compared to our projection of 21,500.
- **Good news on capital inflows** provided a background for VND stability:
  - **FDI disbursements turned in a stable** performance, reaching USD11.0 bn. This is a reliable source of FX for the economy for many years running.
  - **Overseas remittances performed better** than last year, amounting to USD9.0 bn. Most of it came during Q4 when many Vietnamese prepare to go home for family visits.
  - **ODA disbursements** provided an additional supply of USD3.5 bn. The SBV reserves holdings continued to improve, reaching USD15.8 bn at year end.
  - **The trade deficit improved, reaching USD10** bn, as compared to an usual level of USD12-13 bn. The overall BOP balance would be in surplus by USD3.0 bn according to SBV early estimates.



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