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Vietnamese interest rates update

Lower volatility and curve flattening ahead

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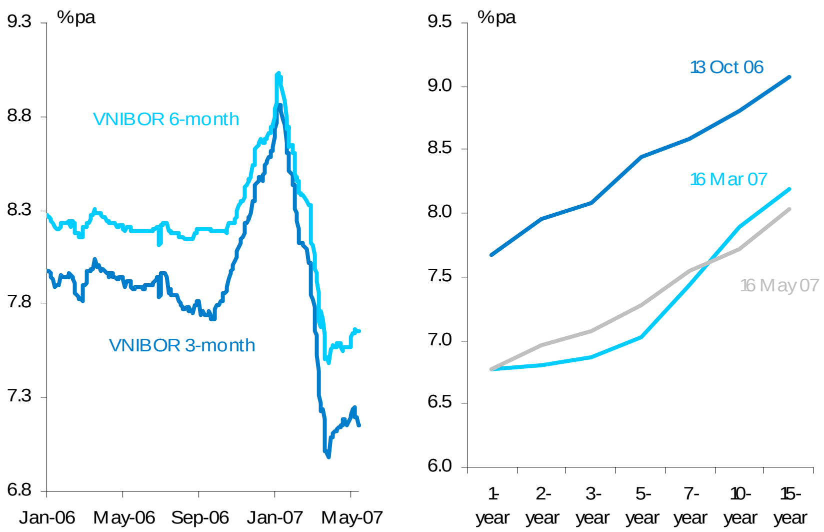
Volatility has risen significantly in Vietnam's interbank interest rates since late 2006. After spending most of 2006 trapped in a tight range between 8.05-7.80%, the 3-month interbank interest rate started to move up sharply last October to peak at 8.86% in January 2007. Following the Lunar New Year holiday in mid-January, the 3-month interbank rate then began to fall sharply, touching as low as 6.98% at the end of March 2007. Since then a sense of 'normalcy' appears to have returned to the market with the 3-month rate rising slightly to 7.15%. A similar pattern can be observed for the 6-month interbank rate (see charts below).

In conjunction with recent moves, the yield curve has flattened as rates have moved higher at the short end of the curve. Although liquidity conditions are normalising, we believe there is still room for more flattening at the short end, as slightly higher inflation should prompt the SBV to encourage further rises in short-term rates.

Vietnam Interbank Rates and Yield Curve



Source: Reuters, Bloomberg

It's all about liquidity

The recent volatility in the VNIBOR rates appears to be a liquidity story. The sharp rise in VNIBOR in late 2006 reflected a slowdown in local liquidity growth. A number of factors drained funds from the local banking system at that time, including increased borrowing in domestic markets and end-of-year tax payments by financial institutions.

Concerned about the impact, the State Bank of Vietnam (SBV) moved to address the sharp rise in interbank rates by injecting funds into the system around the time of the Lunar New Year in mid-January. At the same time, liquidity has been stoked by rising international investment inflows into the Vietnamese equity and fixed income markets in response to the strong economy, increased numbers of IPOs and a shift in Moody's outlook for Vietnam's foreign currency bonds from stable to positive. Remittances, which reached a new record of US$5 billion in 2006, are also likely to have experienced a sharp seasonal rise around the time of the Lunar New Year.

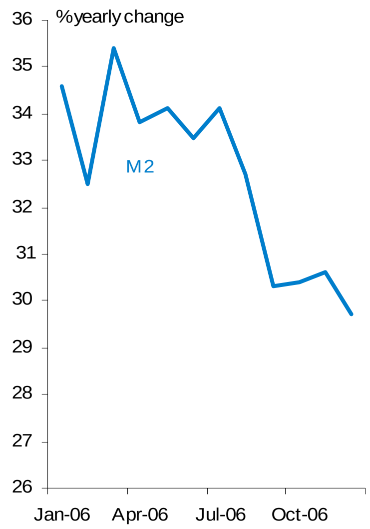
As well as pushing down interest rates, higher fund flows into Vietnam also have put pressure on the Vietnamese dong to appreciate in recent months, most notably in February this year.

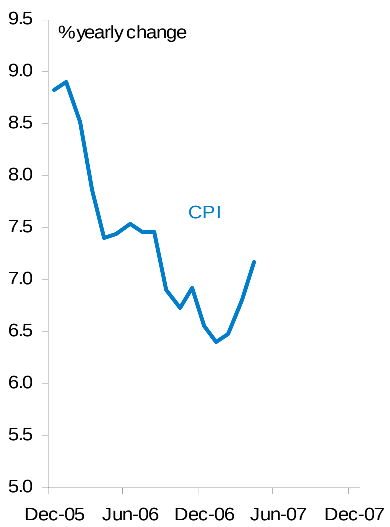
Liquidity has stabilised, but inflation is ticking up

While no data is yet available, local sources suggest that liquidity growth in Vietnam has stabilised since March and that this has capped movements in interbank rates in recent weeks.

Nonetheless, the surge in liquidity experienced over the past six months has supported high credit growth. Inflation is beginning to respond, accelerating to a six-month high of 7.2% in April. This highlights the tensions of Vietnam's current policy regime in that liquidity growth, and thus inflation, is difficult to control when the exchange rate is tightly managed but the capital account is open. This loss of control over monetary policy remains an ongoing macroeconomic issue for Vietnam.

Liquidity growth slowed sharply last year, easing pressure on inflation - now these factors are turning around





Source: Datastream, CEIC

Curve to flatten

Going forward, we expect liquidity growth will slow slightly. Continued strong international investor inflows are likely to be sterilised by the SBV as the central bank works to prevent dong appreciation. Signs of rising domestic inflation pressures will also see the SBV tighten the reigns on money supply. These factors are likely to see short-end rates move a little higher from current levels and the curve slightly flatten. With liquidity conditions stabilising, the recent sharp movements in interbank rates should not be repeated.

Vietnam: macroeconomic and currency forecasts

	2005	2006	2007f	2008f
Real GDP growth (% ch)	8.4	8.2	8.1	8.1
Inflation (%, yr avg)	8.2	7.5	6.9	6.7
Fiscal Bal (% GDP)	-2.1	-1.8	-1.9	-1.8
Current acc. (% GDP)	0.9	1.5	1.7	1.9
FX reserves (US$ bn)	7.0	8.9	12.9	16.5
Currency Forecasts (end-period)	**Mar-07**	**Jun-07**	**Dec-07**	**Dec-08**
USD/VND	16,020	16,059	16,123	16,244

Source: Datastream, Economics@ANZ

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