

## VIETNAM MACRO COVERAGE

## Summary Highlights

- GDP growth expanded to 6.1% year-over-year in Q3 2011
- Headline inflation peaked in August at 23.02% year-over-year, down to 22.4% in September
- Current account balance stands at a surplus of US\$1.3 billion in July
- Lending rates remain high given pressure from cash-strapped businesses

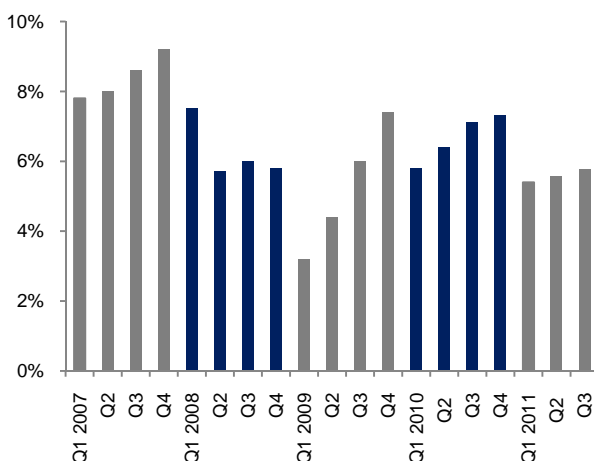
## Policy Tightening Weighs Down on Growth

GDP growth expanded 6.1% year-over-year in Q3, up from 5.7% in Q2 but muted compared to last year, as tight monetary conditions have weighed down on economic growth. Cumulative growth through September decelerated to 5.76% year-over-year, compared to 6.54% recorded in the same period of 2010. The consensus for GDP growth suggest yearend figures will slide below government's 6.0% target, with the IMF and ADB revising down their estimates to 5.8%.

In Q3, Vietnam's dominant economic sectors were again negatively affected by tightening credit measures. Growth in the service sector decelerated to 6.24% year-over-year, compared to 7.25% recorded through Q3 in 2010. The industrial and construction sector slowed to 6.62% year-over-year from 7.28% last year. The agriculture and fisheries sector contracted to 2.39% compared to 3.04% in the same period last year.

## GDP Growth (YTD)

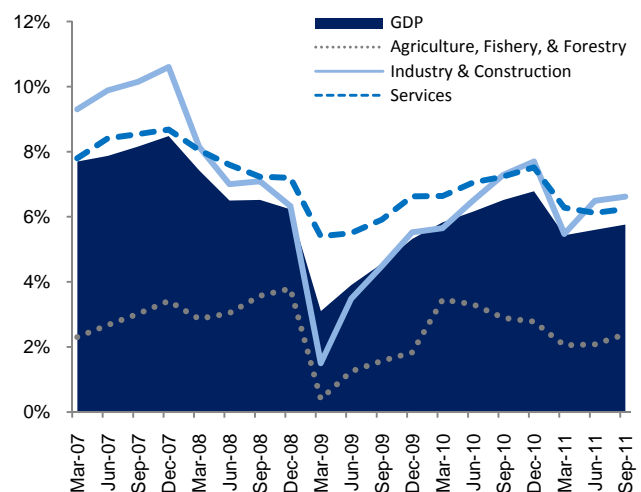
Sluggish growth towards yearend



Source: CEIC; General Statistics Office

## Components of GDP Growth (% YOY)

Growth slows in all sectors



Source: CEIC; General Statistics Office

## VIETNAM MACRO COVERAGE

**Inflation Peaked in August**

It appears that headline inflation finally peaked in August at 23.02% year-over-year, receding to 22.4% in September. While month-on-month CPI accelerated to 1.17% in July (up from 1.09% in June), due to a spike in food prices, monthly price increases moderated to 0.92% in August and down further to 0.82% in September. Policymakers target yearend inflation to recede to 18-19.0% year-over-year. Given the volatility of food and energy prices, however, we expect inflation to remain a cause of great concern for policy makers, and we anticipate that high interest rates and limited credit will remain the tools of choice for the government and that these will continue to exert a numbing effect on most if not all economic sectors, particularly real estate.

**Food prices rose by 33.4% year-on-year and show no signs of ebbing**

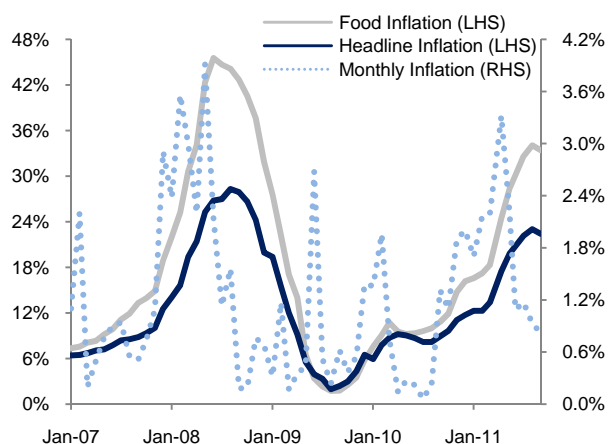
Consumer purchasing power has been crippled by price surges in necessities such as food and foodstuffs. Food prices soared well above the average inflation rate of 18.2% by a staggering 33.4% year-over-year. While tight monetary policies have helped ease month-on-month inflation, food prices pressures have yet to recede.

Despite the fact that inflationary pressures peaked, inflation will remain in double-digit territory in the foreseeable future. Based on historical trends, year-on-year inflation will not fully ebb until the first half of 2012. To ensure that inflation continues to moderate, authorities will have to demonstrate a great deal of caution as they moderate monetary policy, which we do not expect to happen until Q1 2012.

However, a key risk will be potential power price hikes, as have been requested by

**Annualized Inflation (% YOY & MOM)**

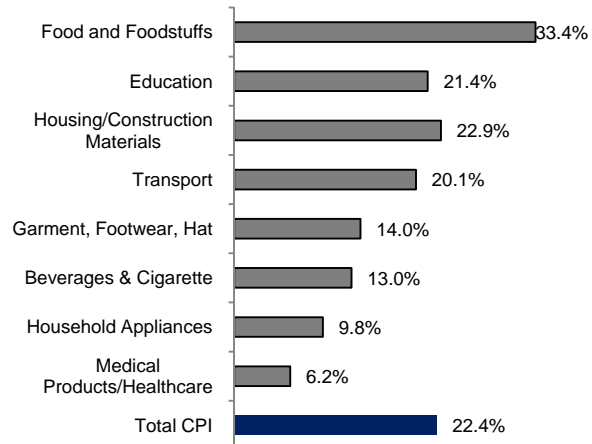
Inflation peaked in August



Source: CEIC; General Statistics Office

**CPI Growth by Sector as of Q3 2011 (% YOY)**

Widespread price hikes



Source: CEIC; General Statistics Office

VIETNAM MACRO COVERAGE

Electricity of Vietnam (EVN). Tariff hikes will certainly stoke inflationary pressures but may be manageable if implemented gradually.

**High Export Turnover Skewed by Gold Exports**

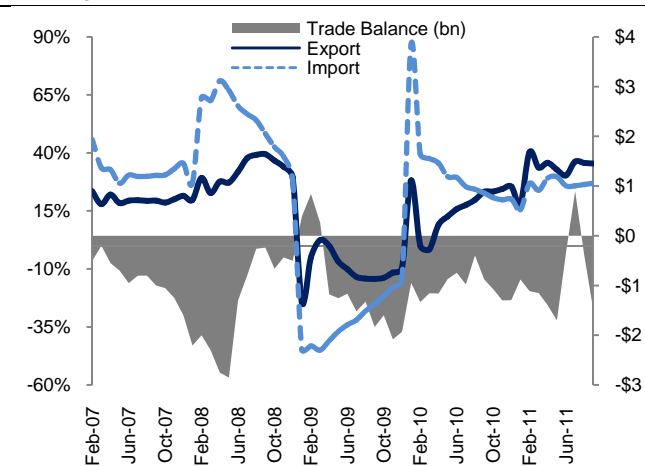
For the first nine months of 2011, export growth increased 35.4% year-over-year, with total revenue amounting to US\$70 billion. September export turnover reached US\$8.3 billion, down 10.2% from the previous month but up 33.5% year-over-year. Textiles and garments rose 31.1% year-over-year with revenue amounting to US\$10.5 billion. Crude oil exports rose by 52.3% year-over-year with US\$5.6 billion in revenue.

**Widening trade deficit weighs in on the VND and the foreign reserves**

Import turnover rose 26.9% year-over-year with total turnover of US\$76.9 billion. Import turnover in September reached US\$9.3 billion, a 3.6% decrease from the previous month but a 31.0% increase year-over-year. In terms of the composition of import items year-to-date, raw materials accounted for 63.3%, capital equipment amounted to 27.3%, consumer goods totaled only 7.7% and gold represented 1.7%.

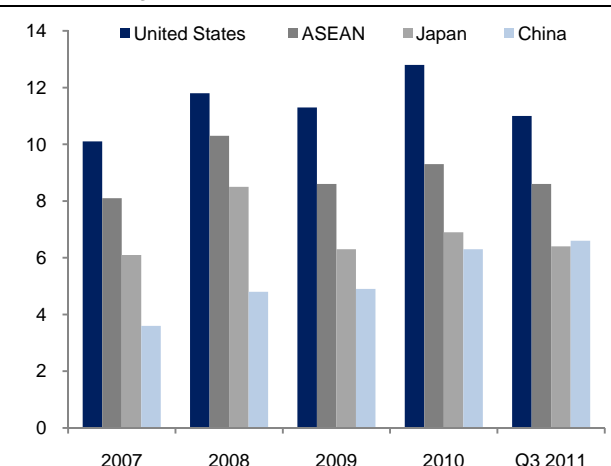
The total trade deficit through Q3 stands at US\$6.9 billion and US\$7.7 billion excluding gold exports. The monthly deficit soared to US\$1 billion compared to US\$.396 billion in August, a figure distorted by high export volumes for gold. The widening trade deficit remains a major concern, as it places pressure on the VND to be devalued and threatens the depletion of foreign reserves. However, the current trade gap is an improvement from last year, amounting to a reduction of nearly 20% from US\$8.6 billion.

**Export/Import Growth (% YOY)**  
Trade gap widens in Q3



Source:CEIC; General Statistics Office

**Exports by Destination (US\$ Billions)**  
Main Trading Partners



Source: General Statistics Office

VIETNAM MACRO COVERAGE

---

**The current account balance reached a surplus of US\$1.3 billion through July**

Furthermore, the government in a rare reporting of the balance of payments indicated that the current account balance stands at a surplus of US\$1.3 billion through July, compared to a US\$3.2 billion deficit over the same period last year. This surplus is attributed to a 43% increase year-over-year in foreign remittances that amounted to US\$5.6 billion. The SBV forecasts a yearend balance of payments surplus of around US\$1 billion, if the errors and omission figures remain low—as it has been on a downward trend from US\$13 billion in 2009 to US\$9.5 billion in 2010. Net errors and omissions constitute a residual category needed to ensure that all debit and credit entries in the balance of payments statement sum to zero. The amount is equal to the difference between reserves and related items and the sum of the balances of the current, capital, and financial accounts.

**FDI commitments down but disbursements remain stable**

From January to September, Vietnam attracted a total of US\$9.9 billion in FDI commitments. Of this amount, the processing and manufacturing sector had the largest registered capital of nearly US\$4.8 billion, approximately 50% of the total. Despite a contraction in committed FDI by 19% from last year, actual FDI inflows have remained steady, rising 1.9% year-over-year to US\$8.2 billion.

For the quarter, Asian countries took over as the dominant source of committed capital, securing the top five positions. Leading the pack was Hong Kong with total commitments amounting to US\$2.8 billion. Singapore trailed with capital commitments of US\$1.4 billion, followed by Japan (US\$712.4 million), the People's Republic of China (US\$555.6 million), and South Korea (US\$431.3 million).

**SBV remains firm amidst immense pressure from the business community to ease lending rates****Still Premature for Policy Easing**

While inflation momentum appears to have decelerated, the CPI is not expected to drop off dramatically until Q1 2012. Year-end estimates for Vietnam's headline inflation rate remain high, and we are forecasting 19-20.0% through December. Against this backdrop, envisage policy easing is premature, and the State Bank of Vietnam (SBV) has remained firm on reducing liquidity. In a recent statement from Nguyen Van Binh, the new governor of the SBV, he indicated that the central bank had revised down growth targets for money supply and credit to below 13.0% and 17.0% from 15.0% and 20.0%, respectively.

From a monetary perspective, the SBV must walk a fine line, balancing the central bank's aim to lower headline inflation and the business community's objections to exorbitant interest rates and limited access to debt financing. Authorities have been under immense pressure from SOEs and private sector manufacturing companies to

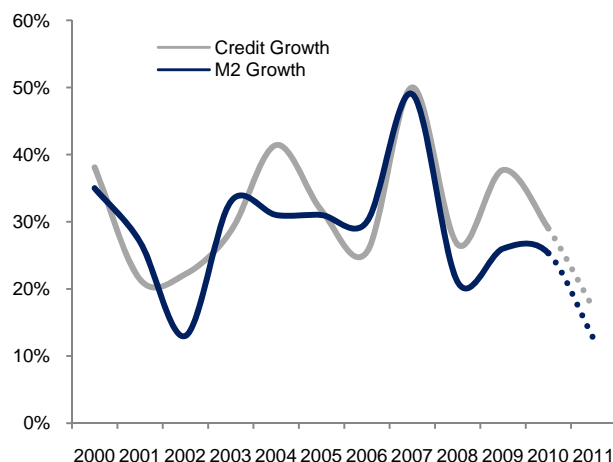
## VIETNAM MACRO COVERAGE

ease policy rates, as average nominal lending rates have exceeded 20% for the majority of the year.

Towards the latter half of Q3, the SBV moved to guide deposit rates lower by enforcing the 14.0% cap for VND deposits, as it had concluded that a handful of smaller banks with weak capital bases were keeping deposit rates artificially high. Actual VND deposit rates peaked at 20.0% in Q2 and moderated to 17-18.0% at the start of Q3. Aggressively enforcing the deposit rate ceiling caused a precipitous drop, with rates receding to the 14.0% cap in September. However, lending rates have yet to follow-suit, and we do not expect the SBV to ease policy rates outright for fear that inflationary pressures will reignite.

**Credit Growth and Money Supply Growth (% YOY)**

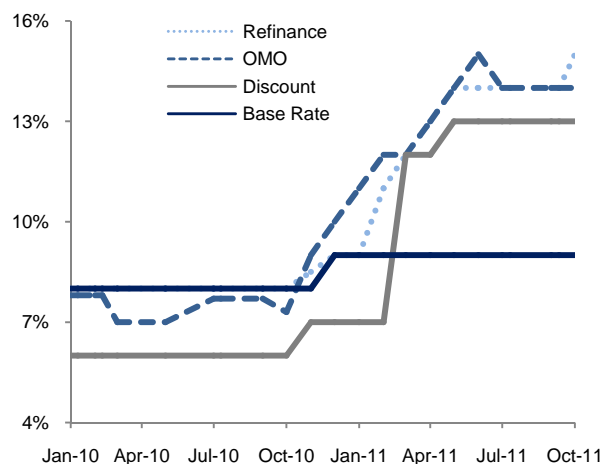
Targeting credit growth below 17% and M2 below 13%



Source:CEIC; General Statistics Office

**Benchmark Policy Rates**

Lending rates remain high to contain inflation



Source: State Bank of Vietnam

**Q4 Growth Expectations Weakened by Global Outlook**

The deterioration of global conditions compounds the effect of the headwinds of tight domestic monetary conditions. As global markets turn bearish, the one saving grace may be a cooling of commodity prices, which may help to weigh down inflation, with the exception of rice prices, which are anticipated to escalate due to regional flooding and the Thai Rice Mortgage Scheme. Following through on election campaign promises (to garner more rural votes since 60% of the population of Thailand is rural), Yingluck Shinawatra's cabinet in Thailand has approved the Unlimited Unmilled Rice Mortgage Scheme starting this month where the government will buy paddy rice at roughly 50% above the current market price. Analysts expect this scheme will increase white rice prices by 58% and hom mali rice

## VIETNAM MACRO COVERAGE

---

### **Vietnam will remain in a precarious state through yearend 2011**

by 55%. Furthermore, floods in Thailand since mid-July have left over two million acres of farmland in Thailand under water.

It appears inevitable that the Eurozone debt crisis and bleak outlook for U.S. growth will impact the Vietnamese economy. Exports to the E.U. are already softening, with reports that garment orders are down 10%. Factoring in weakened global consumption, we expect the domestic economy to continue to underperform its potential and remain in a precarious state through the remainder of the year.

This presents policymakers with the difficult challenge of unwinding policy rates to stave off an economic downturn amidst a climate of high inflation. For the near term, we expect the SBV to stay the course and hold policy rates in place through the end of the year, while resorting to alternative measures through its various lending activities in the refinance window to provide liquidity to the market.