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Vietnam's devaluation

The dong goes for a song

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A flight from the national currency has driven the government to go back on its word

VIETNAM'S elegantly V-shaped recovery would be a terrible thing to spoil on the way to the Communist Party's 11th national congress in early 2011. With that in mind, the government long denied any intention of devaluing the currency. On November 25th its denials went down the memory hole. The state bank lowered the official dong-dollar exchange rate range by 5.2%. In the same stroke Vietnam became the first country in Asia to increase interest rates since the financial crisis began, lifting the base rate from 7% to 8% in an attempt to slow credit growth and attract more dong-denominated deposits.

Over recent years its economy's exposure to the gales of global capitalism has brought communist Vietnam a terrific series of windfalls, and a fair bit of turbulence too. In the first half of 2008, when speculation and inflation threatened to surge out of control, the government was forced to rein in excesses. But it was to reverse itself only months later, as the global slowdown made itself felt.

As the government followed the lead of other Asian nations in trying to spend its way out of trouble—largely through a 17 trillion dong (\$1 billion) interest-rate subsidy programme—it began to build itself a new series of problems.

Current-account and budget deficits widened, foreign-currency reserves shrank, and economists began to question the wisdom of a recovery based on government spending and cheap credit. Currency traders argued that its loose monetary policy would bring back inflation, which hit a six-month high of 4.35% year-on-year in November.

Their view was shared by many ordinary Vietnamese who, having been bruised by hyperinflation in the past, rushed to convert their dong-denominated savings into dollars and gold, the preferred stores of value in a country where only one person in ten has a bank account.

Skittish foreign investors withdrew their money and cautious state-owned enterprises hoarded greenbacks; together, they created a persistent shortage of dollars. With too little hard currency to back it, in the past few months the dong went limp in the black market. The threat of a currency crisis loomed.

Hence the government's volte-face. After lowering the exchange rate and tightening its monetary belt, it went on to egg state-owned enterprises into converting their stake in the dollar—estimated to be worth \$10.3bn—into the wilting dong, to support its value and alleviate the shortage of harder currency.

Many investors were surprised but most welcomed such decisive action, expecting it to stiffen exporters' spines.



Cheaper Vietnamese goods could be bad news for other export-driven economies, whose currencies have tended to appreciate against the dollar this year as investors have worried about the weakness of America's recovery. Thai manufacturers, for example, have cried foul, though Thailand's finance minister insists the impact will be minimal.

This is the dong's third devaluation since the summer of 2008. The hope is that this one will draw a line under the currency's sliding value and provide more lasting reassurance to all investors, foreign and Vietnamese.

If the government is to put Vietnam's monetary policy on a more stable footing for the long run, it must find a way to wean its citizens from their habit of abandoning the dong in times of turbulence. This is no easy task in an economy where already 42% of the total money supply is held in gold or dollars. Memories of soaring inflation remain fresh, making savers loth to hold on to their dong.