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UPDATE: Fitch Warns May Cut Vietnam Ratings As Dong Confidence Crumbles

(Adds Barclays comment on Fitch decision.)

By Leigh Murray

Of DOW JONES NEWSWIRES

Fitch Ratings Friday warned it may cut Vietnam's credit ratings deeper into junk territory, citing weakening domestic confidence in the dong, and said balance of payment support is needed before trust can be restored.

Fitch put Vietnam's long-term foreign and local currency ratings of BB- on negative watch. It also put its short-term foreign currency rating and country ceiling of BB- on negative watch.

The ratings agency said the Southeast Asian country must allow greater data transparency for international reserves and the balance of payments to help avert negative rating action.

"The strength of Vietnam's external finance position, which has provided support to the sovereign's overall creditworthiness, has been sharply eroded as the economy displays signs of domestic overheating and residents lose confidence in the local currency," Ai Ling Ngiam, Director in Fitch's Asia Sovereign team, said in a statement released by the ratings agency.

"Without a strong policy tightening backed by significant BOP support, confidence in the Vietnamese dong is unlikely to be restored," the Fitch statement said.

An official at the State Bank of Vietnam said he was not aware of the Fitch announcement and had no comment.

The Fitch move is the latest sign of pressure on Vietnam's economy. Vietnam's recovery from the global crisis--growth is set to rise to 6.5% this year from 5.32% in 2009--is marred by surging inflation and a wide trade deficit. An interest rate hike Dec. 1 and two currency devaluations since November have done little to fix those problems.

Black market traders Friday were demanding a 4.2% premium for the U.S. dollar over the official dollar-dong exchange rate, underlining weak confidence in the Vietnamese currency. Fitch said the premium indicates ongoing depreciation pressures on the dong.

The central bank recently said flexibility in the exchange rate in coming months was necessary to boost exports, reduce Vietnam's trade deficit and improve its international balance of payments, but economists say a tighter monetary policy is also

necessary to cool the economy, restrain demand-side inflation and help make dong-denominated assets more attractive for foreign investors.

Barclays Capital analyst Prakriti Sofat said in a note that the Fitch move was not justified, arguing that while the dong remains weak he doesn't believe domestic confidence in the currency has deteriorated. He added that Vietnam's trade deficit has improved this year, its external debt is relatively healthy and the central bank has been moving to tighten policy.

"Given this backdrop we believe that Fitch rating outlook change to negative is hasty and short-sighted. It does not take into account the fundamental strength of the Vietnamese economy and the country's long-term potential," Sofat said.

Fitch said official data show gross international reserves have fallen to \$15.9 billion in October last year from \$23.6 billion in September 2008, adding that more recent figures have not been published.

It forecast that foreign exchange reserves may decline to 2.6 months of imports and 1.6 months of current external payments this year--the lowest since 1994 and weakest

"A preference towards Vietnamese dong devaluation to boost exports and the authorities' pro-growth policy measures in the run-up to the January 2011 national congress of the ruling Communist Party point to risks of further build-up in inflationary pressures and a weak policy response," Fitch said.

Further evidence of deteriorating public confidence in dong-denominated assets and rising dollar liquidity constraints--due to robust dollar demand--is the nine failed primary auctions by the State Treasury since last November.

Fitch warned that bond yields may spike further due to increasing interbank rates at a time loan demand is propped up by the government's three interest rate subsidy scheme.

Fitch's Ai Ling later told Dow Jones Newswires the most immediate and effective support for the balance of payments would come from fiscal tightening, while other avenues would include government debt issuance, foreign direct investment, portfolio inflows, as well as bilateral and multilateral support in the form of developmental assistance.

Brayan Lai, credit analyst at Credit Agricole, said the Fitch news didn't mark a major event for the market, given ongoing "expectations that Vietnam faces fiscal and monetary pressures."

Vietnam's 2020 dollar-denominated bond, which it sold in January at 98.576, was quoted unchanged from yesterday at 101.75-102.50, said Singapore-based trader.

Still, the announcement isn't likely to bode well for Vietnamese borrowers that may be looking at tapping the international bond market.

Phu My Bridge BOT Joint Stock Co was reported by state media Thursday to be planning to raise \$700 million from an overseas bond issue to fund the construction of three projects, including the construction of two bridges and a tram system in Ho Chi Minh City. So far, only the Vietnam government has issued overseas bonds.

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