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Vietnam Economics

Quick Comment: More Policy Easing

What's new?: On the back of the government's downgrade of its 2008 GDP forecast to 6.7% from 7%, the Central Bank announced measures to further ease monetary policy. Specifically, the measures are:

a) SBV will cut the base rate by 1% to 12%. The lending rate ceiling is set at 1.5 times the base rate. Today's move will bring the rate ceiling down to 18% from 19.5%.

b) The refinancing rate and discount rate will also be lowered by 1% each to 13% and 11% respectively. The refinancing and discount rate set the rate corridor for open market operations.

c) The reserve requirement for local currency deposits will be reduced from 11% to 10%. The reserve requirement was last raised to 10% from 5% in Jun-07 and than again in Feb-08 to 11%.

This follows the easing measures just announced two weeks ago. Recall that then, SBV cut the base rate, refinancing rate and discount rate by 1% each to 13%, 14% and 12% respectively. Liquidity-injecting measures such as a buy-back of VND20.3trn of bills and higher interest rate (10% vs 5% previously) on compulsory reserves were also announced.

What's changed in the past two weeks?
1) Macro indicators recently released show that the economy continues to be on a correction path from a previously overheated state. Specifically, October numbers show sequential inflation turning negative (-0.2%MoM vs a peak of +3.9%MoM in May-08 and 0.2%MoM in Sep-08). Trade data also show exports and imports cooling off to 19.2%YoY and 3.0%YoY in Oct (vs 44.8%YoY & 14.1%YoY in Sep-08). Consequently, trade deficit stands at -10.5% of GDP (monthly annualized) (vs -53.3% of GDP at the peak in Mar-08).

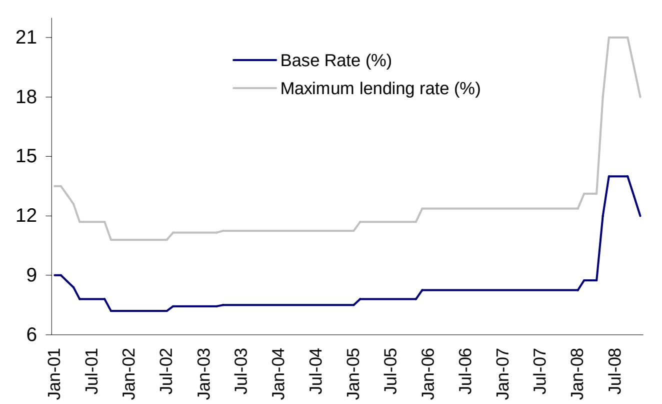
(2) Moreover, the downside to the global macro economy has increased and will likely spill over through trade, commodity and asset markets linkages. This will prove to be growth-dampening and deflationary for Vietnam. Indeed, in the case of Vietnam, the origin of growth risks has shifted at the margin from one that is internal and due to macro imbalances and overheating to one that is due to external slowdown. With the latest data pointing to a correction path, we believe the Central Bank has some room to move from offensive tightening to a more defensive easing stance.

Monetary Easing To Continue But At A Measured Pace: As we last highlighted, the rapid deterioration in external landscape has spurred the initiation of policy rate cuts earlier than we expected. The Central Bank will likely continue on an easing path. However, despite the still-high policy rates and unlike the aggressive monetary easing seen in US (both in terms of magnitude and speedy execution), we continue to believe that Vietnam’s policy easing cycle to bring rates from restrictive to easy mode will be implemented at a more measured pace. This, in our view, is due to the need to balance the domestic risks (economy cooling off from an overstretched state) and external growth risks.

To recap, before the financial events in the US unfolded in October, tight banking sector liquidity was the reason we had previously found meaningful rate cuts unlikely by year-end. We believe the same factors will now also constrain the Central Bank’s ability to ease aggressively and quickly. The banking sector balance-sheet remains somewhat stretched. Credit growth stood at around 39%YoY in Sep-08 whilst deposit growth was around 23%YoY. Incremental credit-to-deposit ratio (calculated as the 12M incremental credit stock divided by 12M incremental deposit stock) stood at around 150%. To be sure, there has been an improvement at the margin and interbank liquidity conditions have improved with 3M VND interbank rates coming down from a peak of 20.8% in Jun-08 to 15.8% currently. Maintaining base policy rates at elevated levels till the credit-to-deposit growth mismatch completely corrects risks the policy error of being overly restrictive. Yet, to the extent that the improvement in interbank rates represent “an improvement from abnormal levels” rather than a “return to normal levels”, we believe the policy easing ahead is likely to continue at a measured pace, unless further downside risks to growth materializes.

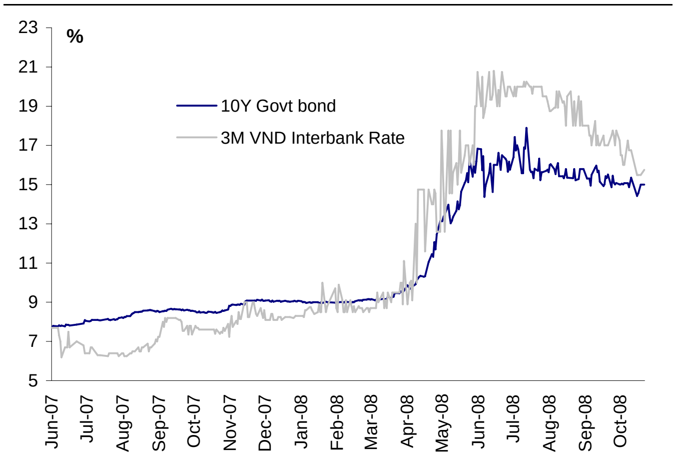
Moreover, financial market conditions and flow of risk capital remain a concern and to the extent that risk aversion continues, we believe tight banking sector liquidity at home needs to be reconciled by bringing external trade deficit down to more sustainable levels. Developments in the CDS markets will also be pertinent as they dictate how effective monetary policy tools will be in bringing down market rates. We expect only another 50bps cut in base rates by year-end.

Exhibit 1
Monetary Policy Taking A U-Turn



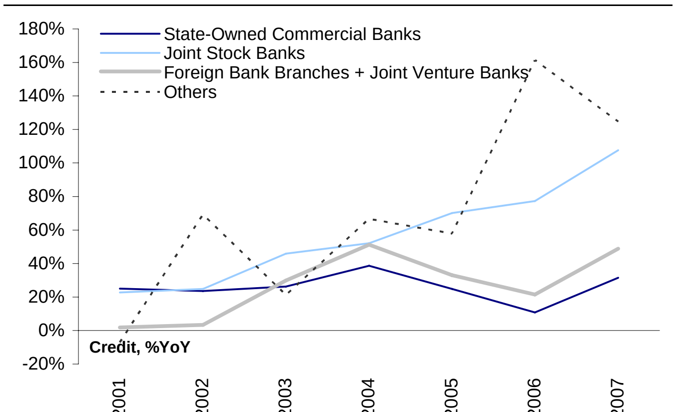
Source: CEIC & Morgan Stanley Research

Exhibit 2
Interbank Liquidity Conditions Have Improved



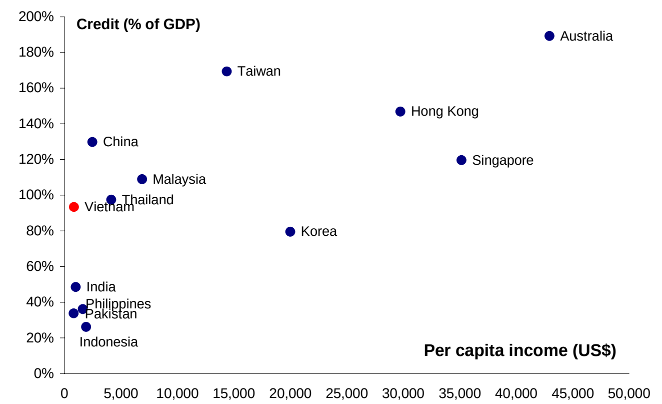
Source: Bloomberg & Morgan Stanley Research

Exhibit 3
Who Has Been Lending?



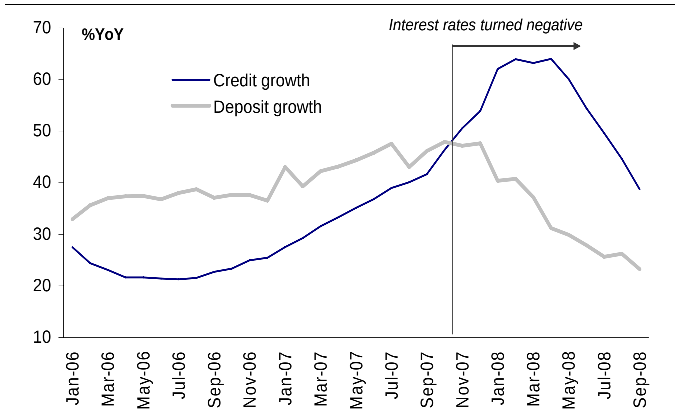
Source: CEIC, ADB & Morgan Stanley Research

Exhibit 4
Running Loose On Credit: High Credit Penetration



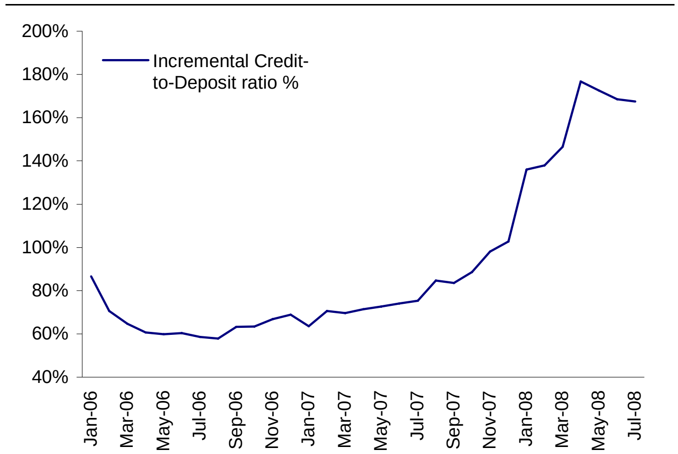
Source: CEIC & Morgan Stanley Research

Exhibit 5
A Credit-Deposit Growth Gap



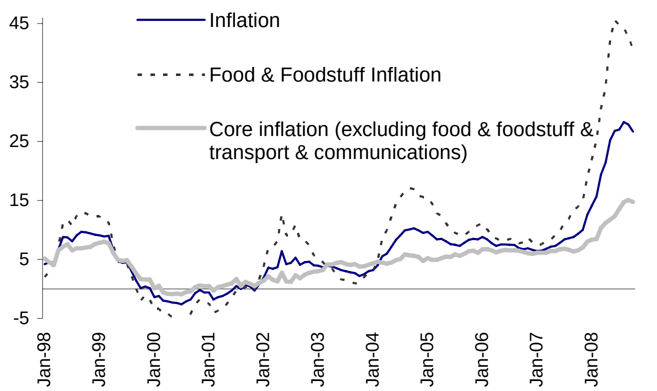
Source: SBV, IMF, World Bank & Morgan Stanley Research

Exhibit 6
Incremental Credit-To-Deposit Ratio



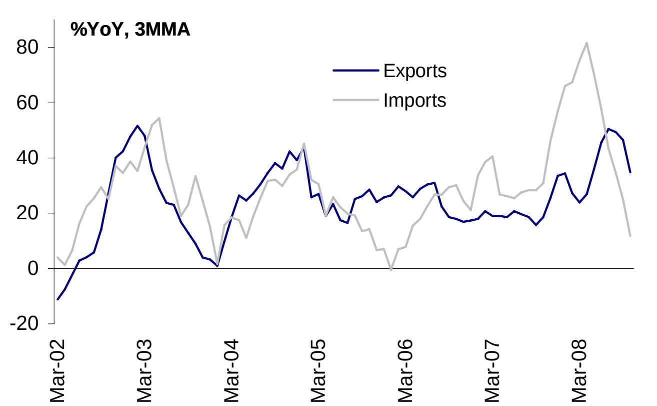
Source: SBV, IMF, World Bank & Morgan Stanley Research

Exhibit 7
Inflation Trend



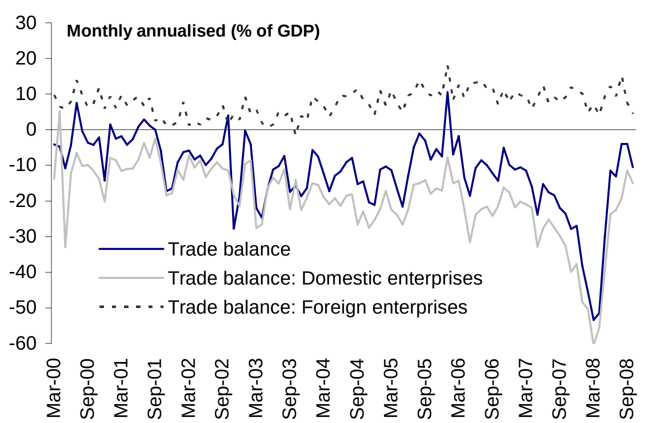
Source: GSO, CEIC & Morgan Stanley Research

Exhibit 8
Trade Slowing Down



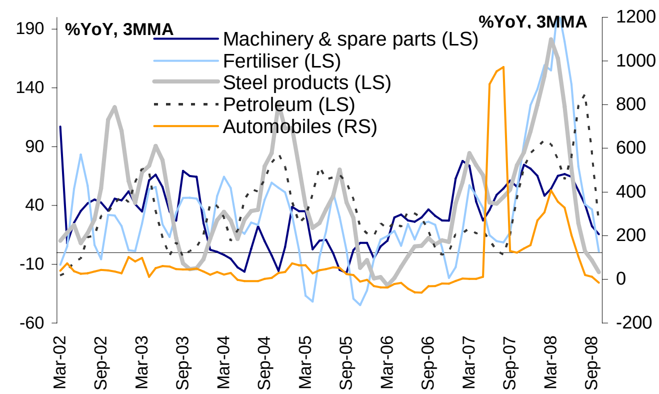
Source: GSO, CEIC & Morgan Stanley Research

Exhibit 9
Trade Deficit Trends



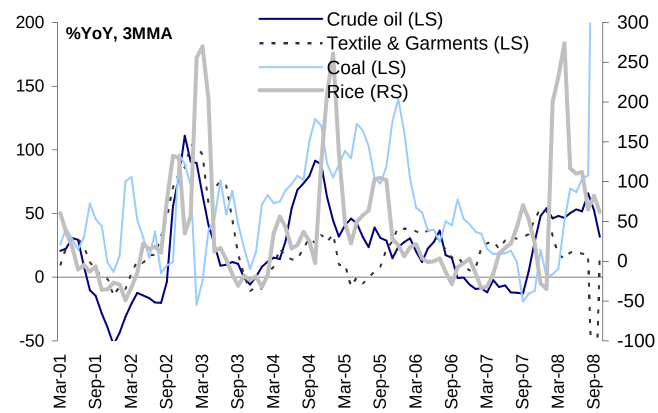
Source: GSO, CEIC & Morgan Stanley Research

Exhibit 10
Import Breakdown



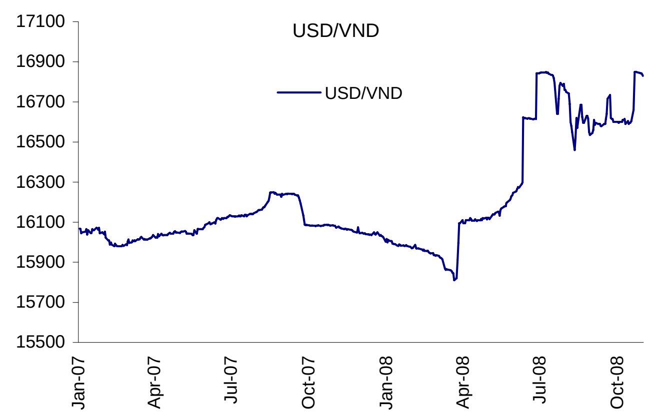
Source: GSO, CEIC & Morgan Stanley Research

Exhibit 11
Export Breakdown



Source: GSO, CEIC & Morgan Stanley Research

Exhibit 12
Currency Movements



Source: Bloomberg & Morgan Stanley Research

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