June 22, 2018

By Michael Kokalari, CFA
Chief Economist

VND falls nearly 1% in one week

- The VN Dong fell nearly 1% this week, including ~0.3% yesterday, and ~0.3% over last weekend
- Investors are probably comfortable if depreciation stays below 2% YTD
- The official reference rate is up 0.9% YTD, so Vietnam's unofficial FX rate is still within the official band of +/- 3%
- Depreciation is being driven by: 1) DXY index, 2) risk aversion, as evidenced by gold prices, 3) USD flows

The unofficial USD-VND rate depreciated 1.7% YTD as of Thursday, June 21, 2018, and currently stands at over VND23,000 to USD1.

Last night's drop of the US Dollar DXY index to below 95 should help ease a bit of pressure on the VN Dong today (Friday, June 22, 2018). Last Thursday's spike up above 95 was the biggest one-day move in nearly two years.

Risk Aversion

The price of gold in Vietnam has traded about 2% above world prices for most of 2018 (a 6-7% premium is typical). However, the gold price premium jumped from about 2.5% at the beginning of June to 3% last Friday (June 15), and up to 4.5% yesterday, an indicator that Vietnamese are exchanging money from VND to gold.

USD Flows in Vietnam

It is our understanding that there are some USD debt payments coming due at end of June that are sucking some USD out of the market (this is also happening in China at the moment). It also appears that the SBV has been buying dollars in recent days, which is the opposite of what they should be doing now because this also puts pressure on the VN Dong. VND interbank interest rates fell by nearly 1%pts over the last two weeks (after the temporary spike up due to the increase in Agribank's reserve ratio requirement), so what the SBV probably should be doing now is buying VND and selling dollars to the market.

Finally, the General Statistics Office's first estimate of the June trade balance is a small surplus. However, these numbers are subject to significant revision (their initial May estimate was a deficit of about USD500 million, which was later revised to a deficit of USD950 million by the Vietnam Customs Department).

Conclusions

If the depreciation of the VND against the USD stays less than 2%, then the VND should not affect the Vietnamese stock markets. However, other factors could continue to weigh on the VN Index, as sentiment towards emerging markets is obviously poor and could get worse with upcoming elections in Turkey and Mexico, for example.

We do not believe that the VND will depreciate by more than 2% against the USD over the next few months, for a number of reasons:

1) The SBV is erring by continuing to buy USD in order to accumulate FX reserves over the last two weeks. We believe that they will stop buying dollars because the rate of VND is quicker than they expected (the SBV only adjusted Vietnam's official reference rate by ~0.1% over the last week). We could even see the SBV selling dollars and buying VND in the next few weeks (see appendix below).

2) The next DXY level being talked about is 97. If the dollar can remain below 97 for the next few months, then we believe the VND depreciation will stay below 2%.

   We do not expect the DXY to go over 97 for the next month because a lot of dollar-bullish news has already come out (e.g., trade war, hawkish Fed, dovish ECB). The next important date for the dollar is July 27, 2018, when Q2 US GDP is announced. The market consensus expectation is very high (~3.5%), which would push the dollar higher (although US GDP growth should slow quickly in 2H18).

APPENDIX: VIETNAM'S FX STRATEGY

We believe the Vietnamese government is copying the same FX strategy that China used in the past, which is to maintain a very stable FX rate against the USD to encourage continued investment inflows from foreign investors.

During the 1997 Asian Financial Crisis, all Southeast Asian countries had huge currency depreciations, but China spent a fortune to maintain the value of the RMB against the dollar to reassure investors.

The stability of China's currency – in addition to other factors such as low wages and a large domestic market – helped facilitate a tidal wave of FDI into China in the early 2000s.