

Michael Kokalari, CFA  
Chief Economist

Huyen Tran  
Research Manager

## Comments on the VND Depreciation

The unofficial value of the VN Dong depreciated by about 1.7% last week, and by about another 1% today to circa VND 23,900 to USD 1. The VN Dong is now down about 3% YTD, which is a bigger drop than we expected, but is a smaller depreciation than that seen by most of Vietnam's regional peers.

We believe the USD-VND exchange rate should stabilize around the current level because:

- 1) The Fed took concrete actions to stop the surge in the USD/DXY index last week
- 2) The State Bank of Vietnam does not need to impose capital controls – so it is **not** contemplating any restrictions
- 3) The VN Dong is supported by high bank deposit interest rates and 33%/GDP of FX Reserves

### **Capital Controls: Not Needed & Not Contemplated**

Foreign investors aggressively sold Vietnamese stocks last week, prompting concerns among some locals that the State Bank of Vietnam (SBV) may restrict the flow of US Dollars out of the country, which was one of the factors that prompted last week's VN Dong depreciation (discussed below):

- In our understanding, the SBV is not contemplating any restrictions on foreign investors from repatriating USD, and that the SBV has more than enough reserves to comfortably meet redemptions (please contact us directly for details about the prevailing sentiment inside the SBV).
- Vietnam's USD83 billion of FX reserves are much larger than the country's cumulative ~USD30 billion of foreign indirect investment (FII) in-flows, and a high proportion of those FII are inflows were into illiquid private equity and/or large strategic stakes in publicly listed companies – both of which cannot be sold quickly. In short, the SBV has more than enough reserves to meet any short-term panic redemptions by foreign investors.
- Note that foreign investors sold around USD260 million worth of stocks last week, but unlike past global "risk off" episodes when investors sold Vietnamese stocks but kept the funds in the country (e.g., at the end of 2018), this time some investors are repatriating USD back to their home countries in response to the current global shortage of USD, which is discussed below.

The VN Dong has been more resilient than its regional peers throughout the COVID crisis:

YTD Depreciations	
Indonesia Rupiah	-19%
Thai Bhat	-11%
Malaysian Ringgit	-9%
Philippine Peso	-1%

*Note that the relative stability of the Philippine Peso is attributable to the after-effects of a 34% depreciation in the Philippine Peso over the five years up to late-2018.*

Finally, we would advise the SBV to continue its policy of allowing investment funds to freely come in-and-out of the country during the current volatile market conditions, because that will reinforce investors' confidence in the country going forward.

Furthermore, since Vietnam has *not* been a major recipient of the "hot money" inflows that destabilized Asean tiger economies in the past (for example, the proportion of Vietnam Government Bonds owned by foreign investors is very low, unlike in Indonesia), the SBV is well positioned to meet any potential short-term panic redemptions by foreign investors.

### **Dissecting the VN Dong's Recent Moves (in Chronological Order)**

- As of the week ending Friday 13<sup>th</sup>, the unofficial value of the VN Dong had depreciated -0.4% YTD, which was essentially unchanged from its level in previous weeks, despite a ~4% surge in the USD/DXY index from March 9<sup>th</sup> to March 13<sup>th</sup> that helped drive ~5% depreciations in the value of the IDR/THB/MYR currencies.
- Last week (ending Friday 20<sup>th</sup>), the VN Dong depreciated by an additional -1.7%, driven by:
  - 1) The USD/DXY index surged about 4% last week, and was up ~8% from its low on March 9th.
  - 2) Foreign investors sold about USD260 million of Vietnamese stocks last week
  - 3) Local investors have been buying gold, as have retail investors globally

Further to point #2 above, foreign commercial banks operating in Vietnam bid up the price of US Dollars in the interbank market because some investors who sold Vietnamese stocks last week are pulling their money out of the country.

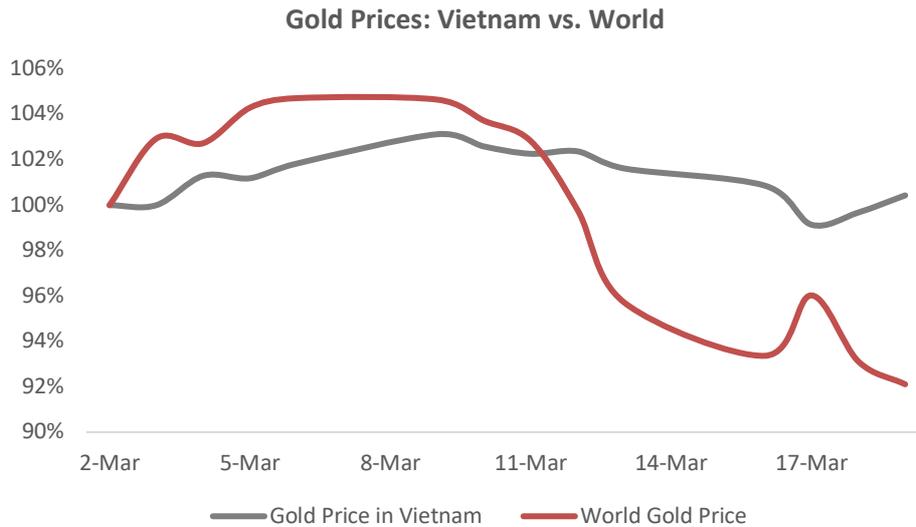
We understand that the scramble by those banks to acquire USD in order to meet investors' redemptions was the initial catalyst that prompted the 1.7% drop in the unofficial value of the VN Dong last week, but as we mentioned above, there were also some rumors that the central bank could restrict access to USD to retreating investors; those rumors seem totally unfounded.

- Today, the circa 1% additional drop in the value of the VN Dong, Thai Baht, Malaysia Ringgit and Philippine Peso are all being driven by the sudden ~4% depreciation of Indonesia's currency to its weakest level since the Asian Financial Crisis.

Note that the weakness of Indonesia's currency stems from the country's reliance on "hot money" inflows to finance the country's circa 3%/GDP Current Account Deficits (foreign investors own nearly 40% of Indonesia's outstanding government bonds), which is not a vulnerability of Vietnam or other frontier and EM Asean countries besides Indonesia.

### **Locals Are Buying Gold**

The price of gold in Vietnam remained fairly stable during the recent sell off in world gold prices.



The divergence in the chart above stems from the fact that local investors are buying gold, but institutions and ultra-high net worth individuals (UNW) in the developed world are selling their winning gold positions in order to cover losses in their other investments, which is weighing on world gold prices.

This same occurred during the Global Financial Crisis, when the price of gold initially *declined* by about 25%, before subsequently soaring, and in our understanding retail investors *worldwide* are currently buying gold – at the same time that big institutions and UNWs are liquidating their gold positions.

The net result of all of the above is that the price of gold in Vietnam traded at a premium as big as 13% to world gold prices in the middle of last week, before ending the week at about an 8% premium to world prices. Vietnam gold prices continue to trade at a circa 8% premium to world gold prices today, which is the level that it typically traded around in the past (note that gold imports in Vietnam are restricted by the central bank).

Note that the gold price premium in Vietnam traded around the 1-2% level for months, up until two weeks ago, but unlike previous instances in which the local vs. world gold price premium widened, we do not believe local savers are currently buying gold because they are afraid to hold VN Dong<sup>1</sup>.

Instead, we think locals are buying gold because they recognize the fact that gold is probably a good investment in these uncertain times, although we are concerned that the widening of the gold price premium could itself become a catalyst that causes local investors to sell the VN Dong because local FX traders watch this indicator closely.

**The VN Dong's Current Strengths & Weaknesses**

***Strengths***

- The SBV bought over USD3 billion of FX reserves YTD (after having accumulated USD20 billion of reserves in 2019), bringing the central bank's total reserves up to about USD83 billion or 32%/GDP.

It is common to cite the amount of a country's FX reserves in terms of the number of months' worth of that country's imports – with three months being the minimum recommended by the IMF, World Bank,

<sup>1</sup> In the past, a surging gold price premium reflected poor sentiment towards the VN Dong. For example, the premium widened to 20% during India's 2016 currency demonetization. However, at the moment it seems that the widening gold price premium reflects gold buying by locals – so our concern is that widening gold price premium could cause a deterioration in sentiment towards the Dong

etc. Vietnam's FX reserves reached *four* months' worth of imports, but this figure understates the degree of support that Vietnam's FX reserves afford the currency because Vietnam's imports and exports are both around 100% of GDP, which depresses the above-mentioned four months' figure.

For that reason, we'd like to highlight that Vietnam's current 32%/GDP worth of FX reserves has nearly reached the 33%/GDP level of FX reserves that China had accumulated just before the Yuan had embarked on a 7-year appreciation that ultimately lifted its value by about 25%.

- Vietnam's trade surplus reached nearly USD3 billion YTD as of mid-March, including a surplus of nearly USD900 million in the first two weeks of this month, driven by 7% yoy export growth.
- Vietnam's deposit rates are attractive compared to regional peers, and are becoming relatively even more attractive as regional peers' central banks slash policy interest rates:

	Policy Rate Cut in March	Policy Rates Cut YTD
<b>Thailand</b>	-25 bps from 1% to 0.75%	-50 bps from 1.25% to 0.75%
<b>Indonesia</b>	-25 bps from 4.75% to 4.5%	-50 bps from 5% to 4.5%
<b>Malaysia</b>	-25 bps from 2.75% to 2.5%	-50 bps from 3% to 2.5%
<b>Philippines</b>	-50 bps from 3.75% to 3.25%	-75 bps from 4% to 3.25%

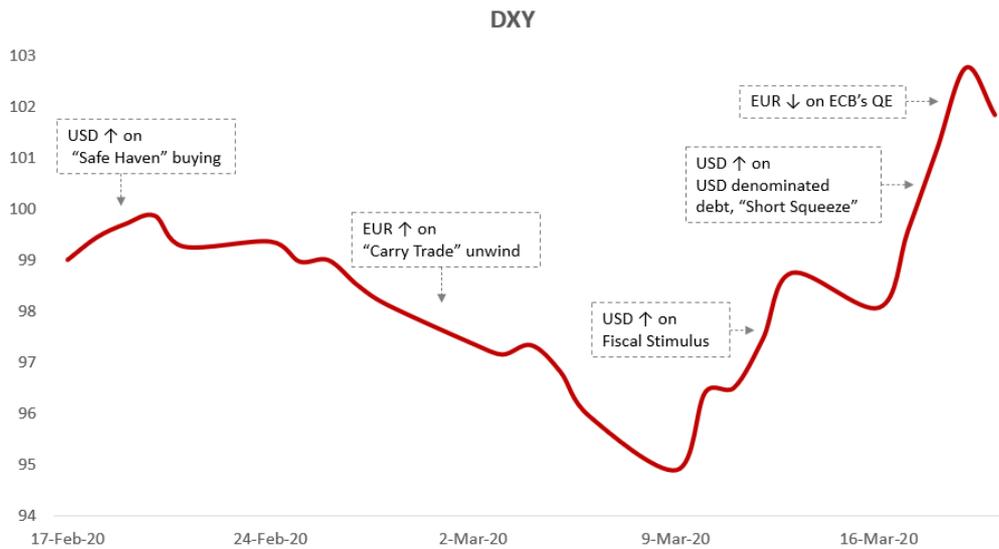
Last week, Vietnam's government also lowered the maximum permissible deposit rate for bank deposits of below 6-months maturity to 4.75%, but savers who are able to lock up their money for 6 months can now earn interest rates of 7-8% from reputable banks, including from some foreign banks operating in Vietnam.

### **Weaknesses**

- The Civil Aviation Administration of Vietnam believes that tourist arrivals could plunge 40% this year, which would flip the country's estimated ~3%/GDP Current Account (C/A) balance in 2019 to a C/A deficit this year.
- In our understanding, local banks are only long about USD200 million of USD at present. The fact that *local* commercial banks are currently long USD, instead of short USD helps explain why last week's VND depreciation was driven by *foreign* commercial banks operating in Vietnam that scrambled to buy sufficient USD to enable the foreign investors who sold Vietnamese stocks last week to repatriate the proceeds of those sales.

However, we would be more comfortable with our forecast that the USD-VND rate will stabilize around the current level if local banks owned more US Dollars, thus enabling them to take profits by selling into the current move.

**Dissecting the USD/DXY Index's Recent Moves (in Chronological Order)**



- 31-Jan to 20-Feb: the DXY increased +3%, driven by safe-haven buying as COVID-19 concerns grew
- 20-Feb to 9-Mar: the DXY fell -5% driven by a surge in the value of the Euro, which was in-turn driven by the unwind of so-called “Carry Trades”.

In short, traders previously borrowed Euros and exchanged those Euros into high-yielding EM currencies like the Indonesian Rupiah, which earning a high level of “Carry” investment income. However, that trade was quickly unwound as COVID concerns intensified.

- 9-Mar to 13-Mar: the DXY increased +4%, driven by: 1) rumors of a huge US fiscal stimulus (note that when a country does a large fiscal stimulus, it typically pushes up the value of that country’s currency and the US stimulus is likely to be a massive 5-10% of GDP), and 2) concerns about a shortage of US Dollars in the off-shore market, which is discussed below.
- 13-Mar to 20-Mar: the DXY increased +4%, driven by: 1) an intensifying shortage of US Dollars in the off-shore market, and 2) the European Central Bank (ECB) increased its Quantitative Easing (i.e., money printing) program from €33 billion per month to €177 billion per month, which depressed the value of the Euro (note that the ECB’s QE previously peaked at €80 billion per month).

**What’s Next for the USD/DXY**

JP Morgan and Credit Suisse both published research reports last week estimating that companies and governments outside the US have essentially borrowed a total of USD12 trillion in USD denominated debt:

- This huge pile of debt (which is nearly equivalent to the entire domestic money supply in the US) entails those foreigners debtors making ~USD1 trillion of annual USD denominated debt payments but most of those companies and governments cannot generate USD denominated income, aside from some commodity producers.
- Companies everywhere in the world are currently hoarding the cash they need in order to survive the current crisis, and many offshore companies are specifically hoarding the US Dollars they need to make

their USD denominated debt repayments. This hoarding of off-shore US Dollars caused the value of the USD/DXY index to soar – which in-turn creates a plethora of economic problems around the world - including in the US. Furthermore, the oil price crash is exacerbating this situation because Saudi Arabia and other oil producing countries do not currently have excess “petrodollars” that they can circulate in the offshore USD market.

- Credit Suisse’s highly influential analyst Zoltan Pozsar (who previously worked at the Fed) published a widely read research report last week, “**The World is Hit With A \$12 Trillion Margin Call**” which advised the Fed to take drastic action in order to address the USD “Short Squeeze” problem.

The Fed took steps to ease stresses in the off-shore US Dollar market at the end of last week, including providing USD114 billion of USD to the European Central Bank, which is the main reason that the DXY index sold off slightly at the end of the week, and we expect the Fed to announce additional measures to prevent the rise in the value of the USD this week:

- The Fed previously provided USD to five of the world’s largest central banks **once-a-week**, but has now started providing USD to on a **daily** basis (technically speaking, the Fed “swaps” USD in exchange for British Pounds, Euros, etc.)
- The Fed previously only provided Dollars to the ECB, Canada, England, Japan, and Switzerland, but has now opened up USD swap lines with the Bank of Korea, Australia, Brazil, Mexico, Singapore, Sweden, Denmark, Norway and New Zealand.

There are two popular theories among international FX traders (the “Dollar Smile Theory” and the “Dollar Milkshake Theory”) that suggest the DXY index could climb to as high as 110 – which would probably cause a major depreciation in the value of the VN Dong. But we think the amount of damage this would cause the world’s economy would prompt the Fed to take even more drastic actions, including providing USD to a much wider range of the world’s central banks, 24/7.

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