

DONG DEVALUATION
Effects on the Vietnamese Real Estate Industry

By Rudolf Hever, William O'Connor and Uyen Nguyen,

Vietnam Research and Consulting

The modern Vietnamese dong was born after reunification, on May 3, 1978. The dong's first revaluation came on September 14, 1985, when 10 old dong became worth one new dong. In recent years, the dong has experienced frequent devaluation mainly due to the pressure of chronic inflation. The most recent devaluation of 9.3% was on February 11, 2011.

Recent Dong Devaluations

Date	USD/VND	Changes (%)	Trading band (%)
26-Nov-09	17,961	5.4%	+/-3%
11-Feb-10	18,544	3.4%	+/-3%
18-Aug-10	18,932	2.1%	+/-3%
11-Feb-11	20,693	9.3%	+/-1%

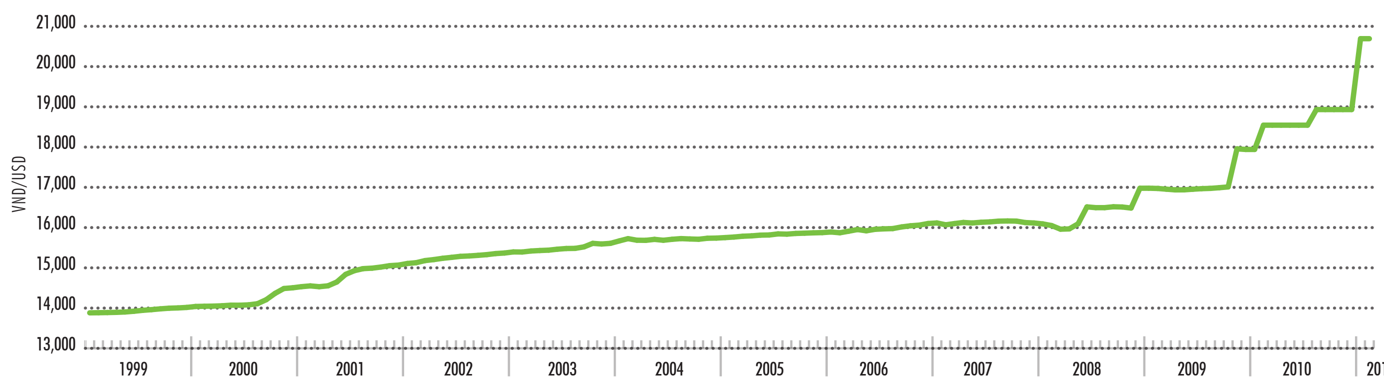
Source: State Bank of Vietnam

While Vietnam's economy saw strong GDP growth in 2010 of 6.8% y-o-y, inflation also rose 2.3 percentage points compared to 2009, ending the year at 9.2%. Inflation is expected to top double digits in 2011 as educational costs, food and foodstuffs, housing and construction costs, and global commodity prices are expected to fuel further increases in the consumer price index. Inflation in February, 2011 was 12.3% y-o-y. In response to rising inflation, and the increasing pressure on the USD/VND exchange rate, the State Bank of Vietnam raised the base interest rate from 8% to 9% on November 5, 2010. Additionally, in 2010 the trade deficit narrowed only slightly to US$12.37 billion from US$12.85 billion in 2009.

The continuing inflation, trade deficit, and the disparity between the official and the unofficial exchange rate have provoked four devaluations in the past 16 months.

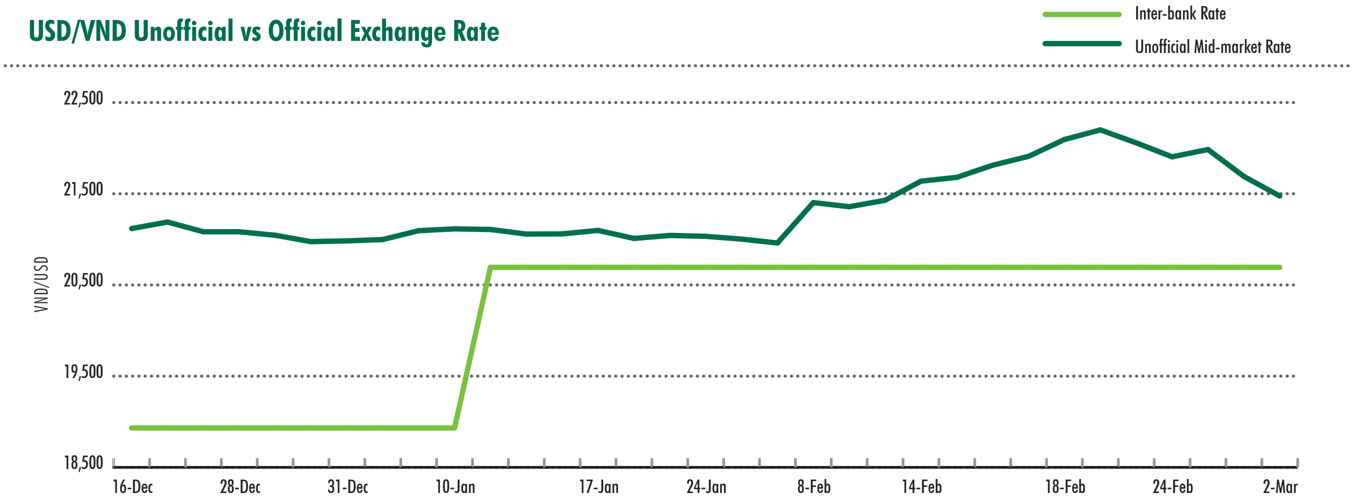
Vietnam's macroeconomic instability and the lack of convertibility of dong on the international market have led to the widespread use of US dollars throughout the economy. In light of continuing macroeconomic instability, and as the USD/VND exchange rate is one of the main tools the State Bank of Vietnam has to manage the economy, it is likely that there will be more devaluations in the future.

USD/VND Monthly Inter-bank Exchange Rate



Source: State Bank of Vietnam

USD/VND Unofficial vs Official Exchange Rate



Source: CB Richard Ellis Vietnam, State Bank of Vietnam

The unofficial exchange rate is of significant importance in the Vietnamese economy. Both name-brand moneychangers and gold shops change dollars at an open market rate, and if the disparity between the official rate, which banks are required to use, and the open market rate becomes too great, banks may stop selling dollars. This exacerbates the demand pressure by cutting off one avenue of dollar supply. International settlements being made from dong accounts may become more difficult as banks may not be able to convert dong into dollars for international wire transfers.

A currency devaluation can either restore or exacerbate confidence in a market. Devaluations can have a creditable effect in instilling confidence, if paired with sound macroeconomic strategies. With an appropriate counter-inflationary policy, and a new exchange rate that reflects the true value of the currency, the market may be conducive to increased capital inflow. If a currency devaluation is perceived to be reactionary, or if it is not coupled with revised macroeconomic policies and anti-inflationary measures, the market can react negatively, which may provoke capital outflow. When devaluation fails to shore-up confidence, deterioration of the perceived value of the currency can be accelerated, further weakening its value.

DEVELOPERS

Developers can avoid some effects of dong devaluation by using a natural hedge. By trying to transact as much of their business as possible in dong, sourcing local materials and using dong denominated labour contracts, the effects of dong devaluation are avoided. In reality, few companies can operate successfully without engaging the international marketplace.

The three main areas where dong devaluation will affect developers are in the sourcing of materials and labour for their projects, the sale price of the final product and the raising of capital. Dong devaluation increases the cost for all imports, including the cost of imported labour such as architects and engineers. The pricing of the final product presents the most challenges. Although not compliant with the law, developers can insulate themselves from the devaluation risk by pricing their products in dollars. Another option is to raise the asking prices of products priced in dong. If developers price their products in dollars, they will run afoul of government regulations. On September 11, 2010, the State Bank of Vietnam issued OD No. 6852 (Official Dispatch No. 6852/NHNN-QLNH), reminding the real estate industry that prices for the sale or lease of real estate must be quoted in dong.

Subsequently, there was increased enforcement of these regulations. There continues to be reluctance for a full scale conversion to dong pricing because developers do not want to accept the increased risk. Owing to the nature of the business, where pre-sales may precede the receipt of the final payment by two years, the risk associated with pricing entirely in dong looms large. A developer could stand to lose a significant percentage of the sale value in the time it takes to finish construction, which would severely reduce the profit of any project.

Finally, if developers are raising capital in dong, a devaluation of the currency means they must raise increased capital to afford the same costs in dollars. If this capital is raised by bank loans, the cost of the interest on the loan must be factored in. Inevitably this cost will be passed on to buyers, which could result is less competitive pricing.

LANDLORDS AND TENANTS

In respect to currency devaluation, landlords and tenants have opposite interests. Landlords that price their rents in dollars are insulated from dong devaluation; therefore, landlords have a great incentive to price in dollars. But, as mentioned above, there is increasing pressure from the Government to abide by regulations requiring dong denominated pricing. If landlords choose to continue pricing in dollars, and avoid enforcement of the regulations, they can successfully mitigate the risk of devaluation and pass that risk on to tenants. However, if the Government steps up enforcement of the existing regulation, as was seen towards the end of 2010, maintaining pricing in dollars may not be feasible. When the pressure becomes great enough, landlords are most likely to shift to dong denominated rents that are tied to the exchange rate. In this situation, the rent will be quoted in dong, with a stipulation that if the exchange rate devalues by a specified percent, the rental rate will reset accordingly.

Tenants have an incentive to request that rental rates be priced in dong, as this would shift the risk of devaluation back to the landlord. This has rarely been seen in the market, and as mentioned, only when the dong rental rate is tied to the exchange rate. With increasing enforcement of dong denominated pricing, tenants would have a greater chance of achieving dong dominated leases, but these will likely be tied to the exchange rate. In the foreseeable future it is unlikely that tenants will have the clout to demand and achieve straightforward dong denominated leases without any tie to the exchange rate.

INVESTORS

For foreign investors, devaluation of the dong can make Vietnam look like a more affordable place to invest. Although, investing in a newly cheaper Vietnam comes with risks. Institutional investors must weigh the affordability or the perceived value of investing in Vietnam with such well known risks as inflation and the overall creditworthiness of domestic institutions. Moreover, once money is invested in Vietnam that investment is subject to the fluctuations of any subsequent devaluation. Currency devaluation also introduces risk into the calculation of the returns on any investment. If the profit on the investment is in dong, there is a transaction cost for repatriating the profit.

SUMMARY

A second dong devaluation is widely expected in 2011 on the heels of the previous four devaluations in the past 16 months. In the short term, developers face higher prices for imported materials and labour. This will be partly mitigated if they continue to price their products in dollars. Landlords and tenants will continue trying to pass the risk to each other, with landlords having the upper hand for now. Foreign investors may see an opportunity to invest with a weaker currency, but the underlying risk of putting money into an emerging market remains.

FOR MORE INFORMATION PLEASE CONTACT:

Marc Townsend
Managing Director
CB Richard Ellis (Vietnam) Co., Ltd.
+84 8 3824 6125
marc.townsend@cbre.com

William O'Connor
Senior Research Analyst
Research and Consulting
+84 93 805 6670
w.oconnor@cbre.com

Rudolf Hever
Associate Director
Research and Consulting
+84 8 3824 6125
rudolf.hever@cbre.com

Nguyen Thi Phuong Uyen
Economics Analyst
Research and Consulting
+84 8 3824 6125
uyen.nguyen@cbre.com

CBRE
CB RICHARD ELLIS