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VIETNAM STOCK MARKET 2011 – AT A GLANCE

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HIGHLIGHTS

- CPI in 2011 is forecasted to increase to 9.5%.
- The Vietnam economy faces obstacles from fiscal and monetary policy. It is expected to stabilize and improve in 2H/2011.
- The Europe's sovereign debt outweighs Japan nuclear crisis.
- The world is facing the risk of high inflation.
- Foreign investors net buying position increased to VND13,300 billion in year 2010 on listed stocks.
- In our view, we expect the market to move sideways with upside bias.

REVIEW OF THE MACRO ECONOMY AND THE IMPACT OF MONETARY POLICY

Vietnam's economy had an impressive GDP growth rate of 6.78% in 2010 compared to 5.32% in 2009 as well as strong growth in both import & export value. However, the growth quality and its sustainable level are still in question to investors.

Figure 1: Some macro-economic indicators

Item	2009	2010
GDP (%)	5.32	6.78
CPI (%)	6.88	11.75
Average exchange rate (VND/USD)	18,479	19,498
Foreign currency reserve (bil. USD)	15.2	10,0
Trade deficit (bil. USD)	12.2	12.4
Credit growth rate (%)	37.7	29.8
Registered FDI (bil. USD)	21.5	18.6
Disbursed FDI (bil. USD)	10	11

(Source: GSO)

The current economic still shows some drawbacks on the quality of growth in Vietnam since it depends too much on invested capital, especially from foreign source when the effectiveness and efficiency of using these sources are not impressive. Vietnam's ICOR index in 2010 was 6.2 much higher than ICOR of other countries in the region during high growth era. It was caused by strong increasing capital investment but low investment efficiency along with the capital-losing phenomenon. Furthermore, the trade deficit also affected the Government's foreign currency reserve (about USD10 billion) and the economic balance recently.

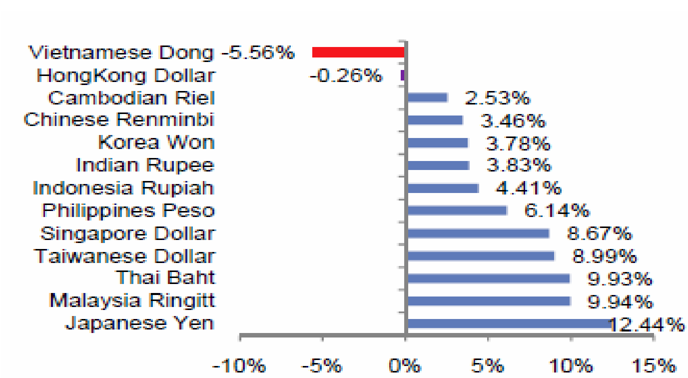
Amongst economic issues, high inflation is the most concern to the economy since (1) domestic commodity prices rised considerably due to impacts of higher global commodity prices (food by 30%, fuel by 25-40%, coal and electricity by 15%...) and (2) strong credit growth in the 2nd half of 2010 which, collectively, put high pressure on domestic inflation. As a result, the Government has been implementing tight fiscal and monetary policies to curb inflation. However, due to high capital demand; commercial banks had to raise deposit and lending rates.

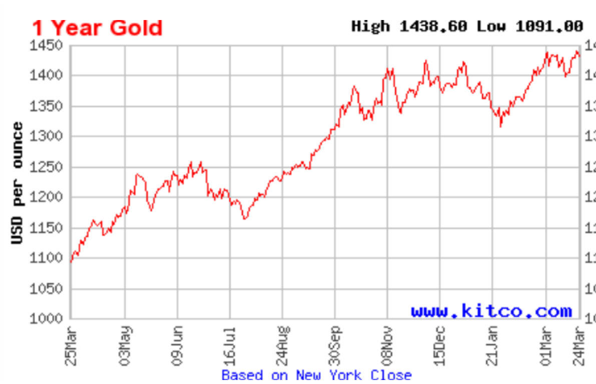
Inefficiency in FOREX policy: despite USD depreciation against other major currencies, VND still depreciated against USD. In 2010, VND depreciated by 5.7% against USD in the inter-bank market and by 8.4% in the free market. The primary cause of this depreciation was due to (1) strong demand for foreign currency (foreign currency credit growth rate increased to 37.76%), (2) declining foreign currency reserve of the State Bank of Vietnam (SBV), (3) payment deficit issue and (4) a large amount of VND pumping into the market at the year-end.

Vietnam's trade deficit still remained at high (USD12.4 billion), although the growth rate of export was higher than import. The disbursed capital from FII, FDI and ODA sources also somewhat helped Vietnam to reduce its trade deficit. However, the overall balance of payment was still on a deficit of around USD4 billion in 2010, mainly caused by illegal gold import. This has put high pressure on domestic currency and exchange rate, especially at the end of the year (i.e. the peak time when many businesses demanded a large amount of foreign currency for importing and paying-off foreign currency loans).

In addition, fluctuations of the gold market also contributed to unstable economic growth. The significant increase of the global gold price had unfavorable influences on the domestic gold price. Coupled with the high inflation rate, low foreign currency reserve and VND's depreciation stimulated speculative activites, consequently leading to a higher domestic gold price (even higher than the global gold price at some points) and gold smuggling activities.

Figure 2: Depreciation of VND and volatility of gold price





(Source: Reuter, Kitco)

The above analysis shows that inflation will continue to be the most concern issue of Vietnam in 2011. The increasing commodity prices which probably will continue to rise in the future along with the adjustment of inter-bank's average exchange rate by 9.3% in 2/2011 (the largest adjustment until now) will, in turn, affect negatively to imported commodity. As a result, the Government has further tightened the fiscal and monetary policies by implementing Resolution 11 in order to control this year's inflation. Policies promulgated by the Government to curb inflation are:

- Increase refinancing rate and discount rate to 12%
- Control credit growth rate in 2011 to lower than 20%, M2 growth rate at 15%-16%
- Reduce public investment by 10%
- Measures to eliminate the phenomenon of parallel exchange rates as well as to remove gold trading in the free market in upcoming time.

In the early months of 2011, the Government set the top priority to curb inflation and stabilize the macro-economy. Thus, it is difficult for Vietnam to achieve its projected economic growth of 6%-6.5% set by the Government. However, inflation is less likely to be kept under the projected rate of 7% when the latest CPI was up by 6.12% in Q1/2011; hence the CPI is projected to increase to approximately 9.5% according to the World Bank's report. Thus, the economy will face some specific obstacles in the first half of 2011. We believe that the macro-economy will be more stable and improved in the second half of the year with the above-mentioned measures. Consequently, the policy will be moderated to a less stringent one if these measures can show their effectiveness.

THE GLOBAL ECONOMY

Vietnam economy in general and the Vietnam securities market in particular are threatened by instability of the global factors such as adverse impacts from the earthquake, tsunami and nuclear crisis in Japan, the political turmoil in Libya, European sovereign debts and the hike in food and agricultural product prices causing fears of a world food crisis.

It is now too soon to estimate accurately total effects of the earth quake on March 11th in Japan on Vietnam's economy since Japan is an important trade partner of Vietnam, ranked no. 4 in 2010 after China, USA and EU. Vietnam export turnover to Japan reached USD7.7 billion accounting for 11% total export turnover, increased 23% compared to 2009. In particular, the tourism industry is the most affected by this earth quake. In 2010, Vietnam had nearly 450.000 Japanese tourists – ranked no. 3 only after the numbers of Chinese and Korean visitors. In the first two months of 2011, total 92.000 Japanese tourists visited Vietnam, however, after the earthquake; many visitors have canceled their tours. In addition, Japanese is considered as 'high net worth' visitors; thus, revenue from Japanese tourists in this year is forecasted to reduce. Moreover, Japan is a big investor to Vietnam and accounts for 22% of the total ODA and 12% of total FDI. Even though Japanese inventors are still keeping their commitments to invest in Vietnam, this figure will fall in terms of growth rate this year as Japan has to focus on rebuilding their country.

Furthermore, after the earth quake, the Japanese Yen is appreciating regardless of abundant money injection from the Japanese Government. The main cause of this phenomenon is the "carry trade" activity of speculators. The strong appreciation of Yen will affect Vietnam's economy, especially foreign debt burden. Japan is the largest lender of Vietnam, and the foreign debt denominated by Yen represents 38% of total Vietnam's debts (source: World Bank). The appreciation of Yen against USD and the depreciation of VND against USD will create negative impact on the Japanese investors' psychology in disbursing capital to Vietnam market, especially the stock market because the realized profits of foreign investors will be eroded by the strong depreciation of VND against Yen.

Beside the Japanese earthquake, the Europe's sovereign debt issue is once again a concern of investors if all related parties could not find any solution to overcome this problem as E.U. and Japan account for 20% and 6% of global GDP respectively. Currently, Greek and Ireland are facing bankruptcy risk while Portugal and Spain's credit rates are downgraded by Moody's. It will be even worse if the Europe's sovereign debt issue is not overcome in time, this problem will spread to a new debt crisis in the U.S. – the world leading economy – which has a strong correlation to the Europe's economy and also the largest-public-debt country in the world (USD12,500 billion in 2010) (according to FED). Finally, other Asia countries will, in turn, be affected significantly as these economies depend largely on strong demands from the U.S. and Europe. Vietnam is also not an exception as the export value to EU and U.S accounts for nearly 37% of the total export value (source: GSO).

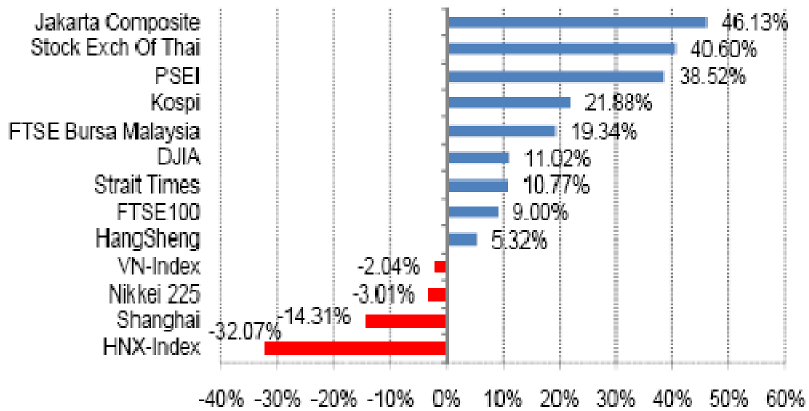
Additionally, high pressure on increasing price of the global food increases economic risks and creates difficulties against many countries' efforts to curb inflation. Especially in the emerging markets, when people have to spend 20% of their incomes for food whereas this number is only 7% in developed countries. According to FAO, the world food price index has increased by 28.3% compared to the level in mid-2010, particularly such commodities like wheat (59% yoy), grain (+95% yoy), sugar (+14% yoy), and coffee (+83% yoy). The primary reasons causing this escalation of the global food prices are the serious drought in Russia which makes this country limit food-exporting, flood in Australia and the worst drought in China for the last 60 years.

Many factors threatening the global economic development are converging at a time and these factors are affecting considerably to the inflation-curbing campaign of emerging countries since it is the "traditional disease" of these nations. Because of this concern, there is a tendency to withdraw capital of investment funds from these countries. From the beginning of 2011, the investors have withdrawn USD24.6 billion from the emerging markets (according to EPFR Global) – this has been the second largest withdrawal since the economic crisis in 2008.

THE VIETNAMESE STOCK MARKET

The Vietnamese stock market is under performed compared to other stock markets in the region for the year 2010. At the year-end, the VN-Index declined 2.04% and the HNX-Index plunged down to 32.07%. During the year, the stock market has (1) significantly increasing stock supply and (2) weak demand force of domestic investors while foreign investors played a supporting role to the market.

Figure 3: Changes of the VN-Index in relation to other indices in region



(Source: Reuter)

The securities market had a disappointed development from the beginning of the year. Many investors expected the securities market in year 2011 would be brighter especially in line with the world economy recovery. Indeed, foreign investors with these expectations, were continuously holding net buying position on the Vietnamese stock market during year 2010 with a total net buying value reached a high record of VND13,300 billion.

However, in actual fact, a series of macroeconomic policies to curb the escalating inflation and improve the balance of payment had crippled the stock market performance. From the beginning of this year until now, the market only had a short up-wave in the mid-January. Then it dropped over the concern on the macroeconomic risks as mentioned above and after Resolution 11 being approved, the market has gone sideways since then.

The Resolution 11 to curb inflation and deal with the macroeconomic turbulence is the right move from the Government. What matter most to the investors currently is the consistent application of the proposed policies? And if they are applying consistently, will the positive results being affected by the world economy that are facing many difficulties?

We believe that the proposed policies will be consistently applied by the Government due to:

- Lessons from year 2010: As we knew in the beginning of year 2010 Vietnam economy was facing the threat of high inflation risk, as a result, Government tightened the monetary policy. However, due to the concern on slowing down the GDP growth, the authorities lifted up the tightening control and consequently the inflation in year 2010 was unable to be controlled at the targeted rate.
- Currently, the foreign exchange reserve of Vietnam is relatively low (USD10 billion at the end of year 2010) hence forcing the Government to reform the economic structure to increase the low foreign exchange reserve.

Based on the above-mentioned belief, Vietnam macro-economy will be more stable. We therefore suppose two scenarios for the Vietnam securities market in 2011 (depending on the world economic situation):

- Optimistic scenario: the world economy still remains its developing pace and does not fall into food and crude oil crisis, European sovereign debt crisis and Japanese economy recovers steadily after the earth quake. Therefore, the tightened monetary policy in turn can curb inflation; import and export turnover can keep its growth pace; and VND will not continue to depreciate. In this situation, interest rate is expected to decline from Q3/2011; and the stock market can revive its uptrend.

- Pessimistic scenario: the world economy may turn back to the recession period due to European sovereign debts and rising inflation because of the hike in oil and food prices. In this context, the securities market will continue to move sideways with low liquidity during 2011 instead of deep decrease because the current P/E 11x of Vietnam stock market is the lowest in the region. Therefore, the probability of a steep decline is not likely to happen.

Besides, the stock market in 2011 is expected to have new rules from the State Securities Commission (SSC). The most notably possible rules are: allowing each investor to open multiple accounts, T+2 trading day, allowing the securities companies to conduct portfolio management business, operation regulations for open-ended funds. These rules will improve the market liquidity and provide an effective capital mobilizing channel for the economy in the primary market.

In conclusion, considering the two scenarios, the Vietnam stock market in 2011 will move sideways pending approval from the State Securities Commission on new regulations. We believe that the Vietnam stock market would be an ideal investment channel this year, especially after new regulations prohibiting illegal foreign currency and gold trading activities. Moreover, real estate investment no longer an attractive investment due to oversupply and high interest rate.

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