VIETNAM GOVERNMENT BOND MARKET

MONTHLY REPORT

July 16, 2008

- *The economy has been shadowed with instability. But there is silver in the cloud with on-going huge inflow of foreign investment into Vietnam*
- *Money supply has been strictly tightened, causing commercial banks to join in a rush of mobilizing domestic currency from any sources despite skyrocketing costs.*
- *Foreign exchange rate between Dong and USD has been wildly fluctuated with 2-tier rate mechanism in existence one again, of which interbank rates are in no effect for trading and those on the black market are climbing up to VND 18,500 per US dollar.*
- *The primary market continues to be frozen with severe shortage of demand for any maturities*
- *2 year bonds are discounted at historical highs of around 22%, but risks of Dong devaluation hovering above the economy, posing the likelihood of higher rates to be offered in the coming time.*
- *Long-term bonds offers lower rates than short-term ones. 15 year bonds are traded with average rates of about 13 %. Yield curve is in inverted shape.*

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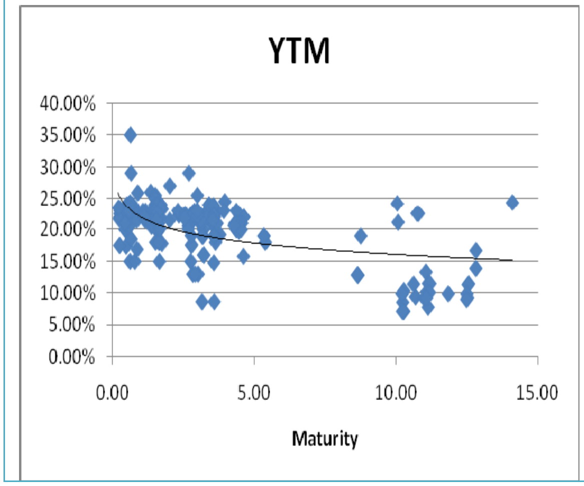
Vietnam Government Bond Market

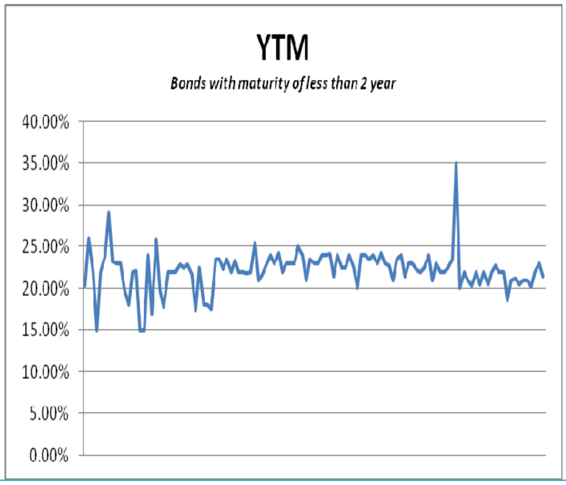
1) Secondary market

June witnessed the high volume of listed G bonds traded on the exchange. Total trading volume amounted to 231 million bonds, an increase of nearly 6 times over the same period of last year. Meanwhile, trading value recorded at 19.97 trillion VND[1] (USD1.18 billion, up by 5 times over last year. On average, daily value stood at VND 908 billion (USD53.7 million)

Short term bonds denominated the secondary market in June. More than 90 % of G. bond transactions were short-term bond ones with maturities of less than 5 years. Corresponding trading value stood at VND 18.22 trillion (USD1.07 billion). Among those transactions, less - than - 2 - year - bond transactions accounted for 68% with total value of VND 12.44 trillion (USD 736 million). In June, a few big trades were also executed with the biggest one worth more USD 24 million and several trades within a range of USD 10 to 15 million.

As indicated in the left hand graph below, rates are at historical high for bond of less than 5 year maturities. Bonds with maturities of more than 10 years are mostly traded at lower rate than those with maturities of less than 5 years. On average, bonds with maturities from 3 to 5 years are traded at around 20.35% and those with maturities of less than 2 years at 21.60%, meanwhile bonds with maturities of more than 10 years are traded at 12.35%.





[1] 1 USD equals to VND 16,846

From trades done in June, rates for various maturities can be listed as follows:

Maturity	YTM
Less than 2 year	21.60%
More than 2 year and less than 3 year	21.23%
More than 3 year and less than 5 year	20.35%
More than 5 year and less than 7 year	18.67%
More than 7 year and less than 10 year	14.39%
More than 10 year	12.35%

Note: Only trades worth USD 100,000 are taken into consideration.

In June, another point of note was that foreign institutional investors sold more than they bought as indicated the table below.

Unit: million (dong)

Trading Day	Buy Vol	Buy Value	Sell Vol	Sell Value
From June 2 to June 6	35,785,560	3,173,701	48,204,570	4,277,999
From June 9 to June 13	26,952,000	2,306,520	43,874,290	3,782,293
From June 16 to June 20	25,242,000	2,035,221	45,801,214	3,891,192
From June 23to June 27	39,809,480	3,319,796	63,495,660	5,408,319
For June	**127,789,040**	**10,835,238**	**201,375,734**	**17,359,803**

Source: Hanoi Securities Trading Center – HASTC.

2) Primary market

Like the previous month, the primary market was still at the standstill in June. Two state agencies authorized by the government to issue G bond almost failed to make issuance via auctions in HaSTC (Hanoi Securities Trading Center). In June, State Treasury/MOF targeted to raise VND 800 billion through 3 auctions but she only mobilized VND 2 billion through issuance of 2 - year bond. The winning rate for this issuance was 11 % and this winning rate was also equal to the ceiling rate imposed by MOF. Other two auctions for issuing 15 year bond and 2 year bond to raise VND 700 billion for Vietnam Development Bank (VDB) were also unsuccessful. The ceiling rates in those two failed auctions of VDB were 11% for the 2 year bond and 12.5 % for the 15 year bond respectively. But ceiling rates for the other two failed auctions of MOF were not released.

Government Bond Issuance in June

Code	Issue date	Maturity date	Tenure	Amnt VND (bn)	Rate (%)	Method	Issuer	Target (bn)
CP081003	01/07/2008	01/07/2010	2	2	11	Auction	MOF	300 billion

Source: Hanoi Securities Trading Center - HASTC

Given trading rates on the secondary market this month, the result of the recent successful auction might cause a bit surprise with the wining rate standing at such a low rate. The best guess is that the ceiling rate for a subsequent auction of VND 500 billion as planned by MOF mid could climb up further in order to have this auction well filled.

Macro Highlights:

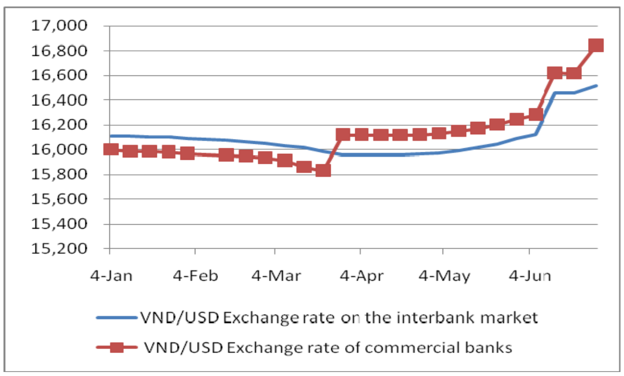
Vietnam struggles to keep the economy running in a way to meet its different and most challenging targets: high economic growth but low inflation, fixed exchange rate to support export-oriented economy, *close* capital account and independent policy ("impossible trinity?")….. to name a few.

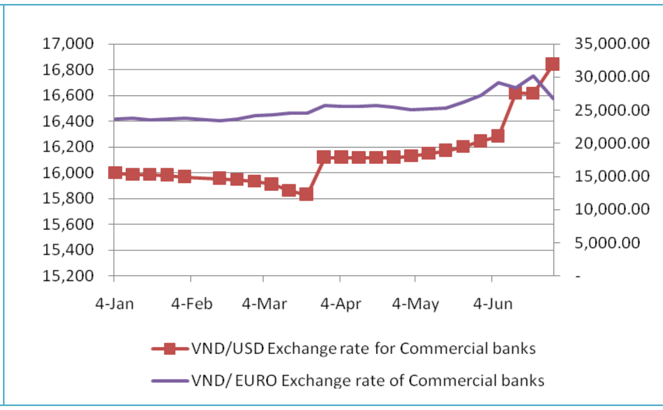
In June, the performance of the economy as a result of various bold measures of most administrative nature, showed some signs of hope for the better but uncertainty still hovering above - for sure - with questions on how to realize "impossible targets". A few major highlights are noted as follows:

- CPI in June 2008 was slowed down with an increase of 2.14% as compared with last month. June witnessed the smallest hike in the first six months of 2008 but this increase in the index was still the highest one as compared with that in any June over the past few years. In comparison with the index recorded in December 2007, June index was up by 18.44%.
- In fact, the government implemented the policy to give heavy subsidy to consumption of petrol, electricity, water until June as announced by MOF by early March. And such subsidy policy, to a large extent, brought about positive impacts to decelerate the inflation.
- USD-VND exchange rate has still been ups and downs in an instable way. In June, USD –VND exchange rate rose by 4.69% over last month. Such rate was higher than the rate of December 2007 by 5.02% and by 4.89% over June of 2007.

But for Euro, value of Vietnam dong was increased in June as indicated in the left hand graph below. Anyway, looking at the whole period, this rate was up by 13% over the beginning of this year. A point of note on Vietnam FX market in June was that there was lack of dollars for sale at the reference prices posted by State Bank of Vietnam (SBV) and commercial banks. Institutions and individuals in need of USD could almost not buy dollars. A two tier price mechanism really existed in the foreign exchange market. US dollars could buy on the black market at a much higher rate than that officially posted by SBV. Rates were in the range of 17.800 to 18.500 dong per dollar on the black market.

- Coping with this lack of dollars, SBV, in fact, took some intervention measures such as : Trading band for USD/VND was widened by +-2 % ; interbank exchange rate was adjusted to VND 16,461and at the same time, SBV continued to sell USD to commercial banks to stabilize the market. In addition, by mid June, Vietnam government publicly announced her foreign reserve of USD 20.7 billion to show their capability to continue the control over the VND/USD exchange rate.





Source : State Bank of Vietnam

- In June, commercial banks still faced the lack of VND as a result of tighten monetary policy for controlling inflation. To solve the liquidity problems, banks had to raise deposit rates to mobilize dongs. After the base rate was increased to 12%. Many banks, especially small ones joined in the race to mobilize dongs by lifting their deposit rate to the top of the band (i.e. 18%) that SBV set for commercial banks to follow. Some banks even offered extra incentives such as gift, lottery-drawing…. to attract further deposits. By mid June, SBV one again, expanded the base rate to 14%. Adjustment to deposit rates by many commercial banks followed suit. But with adjustment this time, rates were somehow stable as in fact, it just helped banks use rates to attract deposits rather than use other "unofficial" incentives to implicitly raise the rate without violating the regulations of SBV on the band for deposit rates of commercial banks. Table below indicated rates for different terms offered by commercial banks in June:

Bank / Term	VCB	SCB	South Asia	Tech	ACB	Interbank market
Overnight						18.16
One week	14.50	17.10	17.40	16.70	16,15	18.52
Two week	14.50	17.40	17.16	16.85	16,20	17.79
Three week		17.60	17.28	17.00	16,25	
One month	16.50	17.80	17.88	17.85	16.65	17.64
Two month	16.50	18.00	17.88	17.95	16.80	
Three month	16.50	18.10	17.88	18.05	16.85	15.83
Six month	16.50	18.50	17.76	18.35	17.05	14.00
One year	17.00	18.5	17.76	18.35	16.64	12.50
Two year	17.00		17.64	18.35	13.70	

- Vietnam import continued to exceed export in June. Import turnover was estimated to stand at USD 6.8 billion, a decrease of 11.3% over last month but up by 33.7% in the same month of 2007. Import value in June exceeded export value by USD 1.3 billion. The corresponding figures for previous months are USD 3.28 billion in March, USD 3.2 billion in April, USD 1.91 billion in May.
- Despite economic difficulties facing the economy, FDI has been on the increase. Up to June 20th 2008, registered FDI has been worth USD 30.9 billion, up by 324,3% over the same period of 2007. Such amount was far higher than the total of USD 21.3 billion recorded for the whole year 2007.

Investment Remarks with conclusion

Long-term bond rates are currently much lower than short-term ones. Theoretically, it is expected that this is a sign to show optimistic views of investors over Vietnam economy, i.e. inflation and long term rate will drop in the future. Looking into the economy, in fact, figures on FDI somehow are promising. At the same time, economic indicators such as inflation, export-import…. also indicate positive improvements. They all show a fact that there is some clue to believe in the better performance of the economy in the coming time.

However, it should be cautious for any long term commitment in the bond market as difficulties still loom large in the economy, causing profit-making by holding long-term bonds in doubt. And with inflation standing at a double digit rate and lucrative rates for depositing money at commercial banks, investment in long-term bonds using loans with high borrowing rates seems risky. For those, who can leverage their bond investment via low rate loans of hard currency, i.e. USD, it may also be not good to take risks to invest in long-term bonds but purchasing short-term bonds could bring about good profit with less risk. This is because Vietnam dongs are pegged to US dollar with a nearly fixed VND/USD exchange rate. With a rather big reserve, it is quite possible to expect the current exchange rate kept unchanged for a while. A best guess is that it would be unchanged in the coming quarter or could extend to the end of this year

Anyway, exchange rate risks hover around. Unless confidence in the government maintains, SBV is not in an easy position to intervene in the exchange rate market successfully as its reserve is soon depleted if it does so. Domestic devaluation is, as a result, inevitable by then.

Another point of note is that the government identified inflation control as their major target. Constraint of liquidity in the banking system is quite possible to continue in the banking system up to the end of the year. If so, there can be no shortage of short-term bonds from the source being commercial banks. Commercial banks, especially state-owned ones hold a huge amount of G. Bond. To deal with liquidity problems, liquidating bonds would be the best choice for banks as it is not easy or even impossible to raise deposit rates further for getting enough liquidity due to regulations over the base rate and deposit rate. Therefore, it is expected to easily purchase short term bonds at a great discount from those banks in the coming time.

In conclusion, short-term investment can be valuable but the market should be closely watched.

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