



June 2011

Stagflation Risk Threatens Vietnam's Growth

Vietnam's economy expanded rapidly in the past 10 years. From 2000 to 2010, its GDP growth at about 7.2% per year, with economic size doubled. Investors admired its potential and it has entered into the economic group such as, NEXT-11, VISTA, CIVETS & MAVINS.

Unfortunately, the impact of over-expansion had aroused after the economic Tsunami. After the "super rebound" in 2009, Vietnam's stock market becomes unattractive and there was panic sell in May.

Vietnam's VN index slumped 14.4% starting from 16 May to 27 May. According to Ho Chi Minh City Stock Exchange, investors sold a net 171.1 billion dong of Vietnamese shares in four trading days since May 20.

Compared with other Asian countries, Vietnam's inflation is extremely high. The statistical department announced that the consumer price index in May had reached a record high of 19.78%, much higher than April's 17.51%. The CPI raised 2.21% on the monthly basis. Food inflation jumped 28.3%, while prices for housing and construction materials surged 21.1%

The university's Vietnam Center for Economic and Policy Research released its annual economic report, titled "Economy at the Crossroads," on 24 May. This year's report looked at two scenarios for the economy.

If the government is consistent with its tightened policy stance throughout this year and public investment is slashed, inflation will stand at 15.5% at the end of the year. A lower inflation rate is also possible if prices of materials fall sharply in the final months. The economy, in this scenario, will expand by around 6.2%.

However, if the government decides to loosen its grip on the policies under pressure of business community – a move already seen in the third quarter last year, inflation could hit a record high of 18.2%. In this case, even if growth is a little bit higher, at 6.5%, economic instability will lessen the value of that growth.

In order to tame inflation and credit (the credit growth 27.7% last year), the central bank has increased the interest rate for six time this year. The rate has doubled to 14% from 7% in early November last year.

We think it's hard for the policy makers to curb the inflation expectations at this moment, because the interest rate hike is too late. Since the rate has risen sharply in short period of time, it may hurt the economic growth and increase the risk of stagflation. In fact, the government has lowered the forecast of economic growth from 7%-7.5% in Dec 2010 to 6.5% in May 2011, whereas inflation forecast has adjusted upward significantly from 7% to 11.75%

Vietnam is an export oriented country, whose export & import accounts for 70.6% and 82.7% of the GDP in 2010. In order to stimulate the economic growth and narrow the trade deficit, the government has devalued the dong for several times, but the devaluation could deepen inflationary pressure and fasten capital outflow, which would therefore reduce the foreign reserve and deteriorate debt repayment capability.

Fitch and Standard & Poor's had downgraded Vietnam's Local and Foreign currency ratings in July and November last year respectively. Moody's also cut the nation's sovereign-debt rating deeper into junk status in December 2010. The rating agencies may take further action because the situation is not getting better.

The corporate governance is another concern. Vietnam Shipbuilding Industry Group was accused of manipulating the financial statements last year, which had hurt the investors' confidence.

Vietnam's stock market may rebound after the free-fall, but unless the inflation is under control, the uptrend cannot sustain. Chinese policymakers should take a lesson from Vietnam.

Important Notice:

The information contained within this document is for the information of prospective clients and existing clients of Arcadia Financial Services (Asia) Ltd (here after AFS) and/or Arcadia Asset Management (Asia) Ltd (here after AAM). The information is not intended to be a recommendation, offer or solicitation to buy products, securities or services. Products and securities described within this document are not applicable to all persons of all nationality, residence or domicile. Persons interested in making any investment or purchasing any products or securities described within this document should inform themselves as to the legal requirements in their country of nationality, residence or domicile.

Investment in securities carries risks. Past performance is not necessarily a guide to future investment performance. If there is any doubt, you should seek advice from your financial consultant before contemplating any investment.

The information contained within this document is believed to be correct and was obtained from sources believed to be reliable, but accuracy, timeliness or completeness cannot be guaranteed. AFS and AAM cannot be held responsible for any errors or omissions contained within this document or for any consequences arising from the use of this document or the information contained within it.

If you want to receive Arcadia Market Commentary or you have any comments to us, please send to us by email: servicing@arcadia-asia.com or contact us at below at no obligation. Information sent to us will be treated strictly confidential.

**Arcadia Financial Services (Asia) Ltd
Arcadia Asset Management (Asia) Ltd
Room 1404 &06, Leighton Centre, 77 Leighton Road, Causeway Bay, Hong Kong
Tel: (852) 2114 8488 Fax: (852) 2111 0777**