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RISKS TO WATCH VIETNAM

Vietnam reported economic growth of 7.16 percent in the third quarter, but inflation soared 11.1 percent year-on-year in November, and the trade deficit also expanded, raising concerns about economic imbalances that could scare off investors. Fitch cut Vietnam's credit rating on July 29 to four notches below investment grade, and criticised inconsistent policy. The southeast Asian market, once a favoured frontier investment, is seen as risky and opaque for investors.

GOVERNMENT EFFECTIVENESS, TRANSPARENCY

The ruling Communist Party is preparing for a national congress in January 2011 at which several members of the all-powerful Politburo, as well as underlings, are expected to be reshuffled. Behind-the-scenes jockeying for power is under way and will colour all major policy decisions, analysts say. With under two months to go there is still uncertainty about who will occupy top posts, including party chief, president and prime minister. This elevates the risk of unpredictability in policymaking in a system already plagued by bureaucracy, opaque decision-making and weak accountability. Policy paralysis is also a risk as factions and players compete before the congress. This may have been on display when the latest bout of currency weakness struck, with critics saying the authorities acted too slowly when the dong came under pressure in late October and early November.

In a move many saw as linked to pre-congress politicking, the Party last month **removed the chairman of Vinashin**, a giant, overextended state-owned shipbuilding conglomerate that was sinking in debt. The firm is being reorganised, and parts were hived off to better-performing state-owned companies. Analysts say Vinashin is closely associated with Prime Minister Nguyen Tan Dung, who is eligible for a second term but has his detractors. Vinashin's first overseas debt comes due late next month and **it has asked creditors, including Credit Suisse, for a one-year delay**. As of Nov. 26 the answer was unclear.

A separate issue that analysts see as likely to be linked to the congress is a renewed crackdown on dissenters. Several people have been arrested or convicted in recent weeks for peacefully expressing their views.

What to watch:

- Who's up and who's down in the political manoeuvring before the party congress. Watch for scandals in the press. Foreign investors will be monitoring the Vinashin debt saga.
- The renewed **crackdown on dissent** could dent relations with key trade partners like the United States and the European Union. Watch for more arrests or criticism from abroad.
- In the longer term, investors list **poor infrastructure**, including an inadequate power grid, as one of Vietnam's major barriers. The government's ability to coordinate swift, efficient development in this area after pledges of record official development assistance is a key issue.



EXCHANGE RATE AND MONETARY POLICY

Vietnam's tightly managed **exchange rate** is a regular source of economic pressures. The central bank has devalued the dong five times since mid-2008 and **confidence in the currency remains weak**.

The gap between unofficial and official currency rates has widened as year-end pressures, exacerbated by a spate of dollar loans coming due, push the black market rate down. The authorities announced in early November that they would not devalue the currency from now until at least February, but would instead try other ways to control the exchange rate. The central bank then raised policy rates for the first time in 11 months.

Still, **the exchange rate remains weak**, trading around 21,200 dong per dollar in gold shops and unofficially between banks, 8 percent weaker than the legal low limit of 19,500 as mandated by the dong's trading band.

In terms of policy instruments, the benchmark base rate lost much of its significance when the State Bank of Vietnam freed lending rates from a cap linked to it. It remains to be seen what will replace the base rate as the benchmark, and officials say the issue is still being discussed. Meanwhile, rates have been all over the map.

A soldier holds a rifle in front of a giant image of Vietnam's late revolutionary leader Ho Chi Minh, outside a ceremony to celebrate his birthday in Hanoi.
REUTERS/Nguyen Huy Kham

RISK DATA

Sovereign foreign currency:	
S&P	BB (negative)
Moody's	Ba3 (negative)
Fitch	B+ (stable)
World Governance Indicators:	
Voice & Accountability	7.6
Political Stability	51.4
Govt Effectiveness	46.2
Regulatory Quality	31.0
Rule of Law	41.5
Control of Corruption	36.7
IHS Global Insight	
Country risk	2.95
Sovereign	BB- (stable)
Economist Intelligence Unit	
Sovereign risk	CCC
Political risk	B
Country risk	CCC

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What to watch:

- The gap between black market dollar/dong rates and interbank rates, which are a key gauge of pressure on the currency.
- Steps taken by the authorities to bring the trade deficit under control.
- Whether Moody's and Standard & Poor's, which both have a negative outlook on their Vietnam ratings, eventually follow Fitch and downgrade the country.
- Announcements on new monetary policy instruments..

CORRUPTION

Corruption is endemic in Vietnam at all levels of government and a major barrier to foreign investment. The authorities regularly reiterate a commitment to aggressively fighting corruption, and had encouraged the media to act as a watchdog, but several journalists were detained in 2008 for reporting on major scandals. There is a stream of small cases reported in the state-controlled media. Progress on graft will remain a key determinant of long-term investment attractiveness.

In Transparency International's 2010 Corruption Perceptions Index, Vietnam's rank rose slightly to 116 from 120 the previous two years, suggesting little change in corruption levels. .

What to watch:

- Corruption scandals sparked by political manoeuvring ahead of the party congress.
- Vietnam's rank in corruption perceptions rankings. A strong improvement or decline might influence long-term investment, although there would have to be fundamental underlying change.

SOCIAL UNREST

Reports of social unrest periodically surface in Vietnam, mostly over labour and land disputes. Actions may be linked to perceived economic injustices or corruption, although religion and politics have played a role in some recent demonstrations.

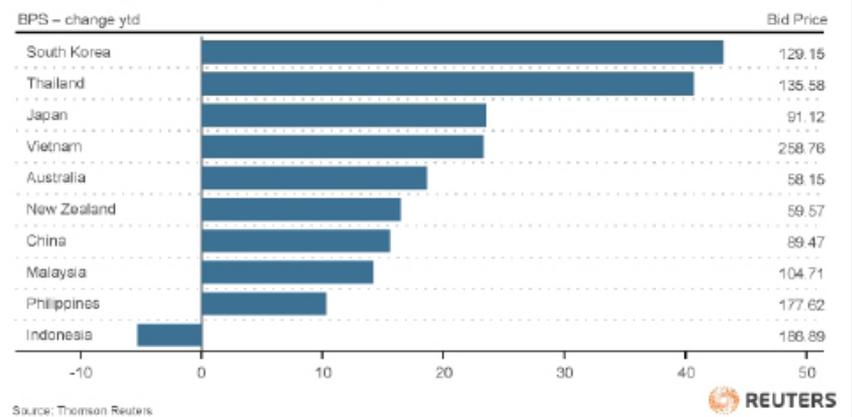
Recent protests include a demonstration near Hanoi in November over plans to build a cemetery that residents opposed. Protesters temporarily detained the deputy Communist Party chief of the district. In late July several thousand people in Bac Giang province demonstrated over the death of a driver while in police custody. During the summer, unusually dry conditions led to widespread blackouts that sparked protests in rural areas.

Three years ago there were anti-China demonstrations in Hanoi over disputed islands in the South China Sea, a topic that has resurfaced in the face of growing Chinese assertiveness and the apparently increasing frequency of detentions of Vietnamese fishermen by Chinese patrols.

There is no evidence for now that widespread unrest is likely, or that there is any imminent risk of the regime being challenged from below.

Asian sovereign CDS in first half

Indonesia outperforms while South Korea lags in first half of 2010

**What to watch:**

- Any sign that a broader national protest movement is emerging out of local disputes. So far, this seems unlikely.
- **Territorial disputes in the South China Sea.** This issue is highly charged in Vietnam, where **suspicion of China** runs high. Any move by China to assert sovereignty over disputed islands in the South China Sea, or perceived weakness by Vietnam on this issue, could galvanise broad-based support for demonstrations.
- The **role of the Catholic church.** Catholics have engaged in periodic protests over church land taken over by the government after 1954. The Catholic Church, while officially shunning involvement in politics, has 6-7 million followers in Vietnam and is well organised. Some priests have been outspoken about human rights and democracy.
- **Volatile commodity prices.** Reports have emerged of **coffee farmers who made losses when bean distributors went broke this spring** ransacking their buying agents' homes and businesses.

RISK DATA

JLT Group	
Strikes, riots & civil unrest	5
Terrorism	2
War & civil war	2
Economic risk	6
Currency risk	5
Sovereign risk	6
Expropriation	6
Contract repudiation risk	7
Legal & regulatory risk	7
Coface	
Country rating	B
Business climate	C
Transparency International	
Corruption Perceptions Index Score	2.7
Rank (of 180)	120
World Bank Doing Business	
Rank (of 183)	93
WEF Global Competitiveness	
Score	4.27
Rank (of 133)	59
Reporters Sans Frontières	
World Press Freedom Index Score	75.75
Rank (of 175)	165

KEY DATES

- **January 1, 2011**
Revised central bank law comes into effect, with interest rate policy in flux
- **January 2011**
11th National Congress of the Communist Party of Vietnam.
- **February 2-5**
Tet holiday for lunar new year
- **July 8-9, 2011**
Vietnam Investment Summit in Hanoi

