FX Flash

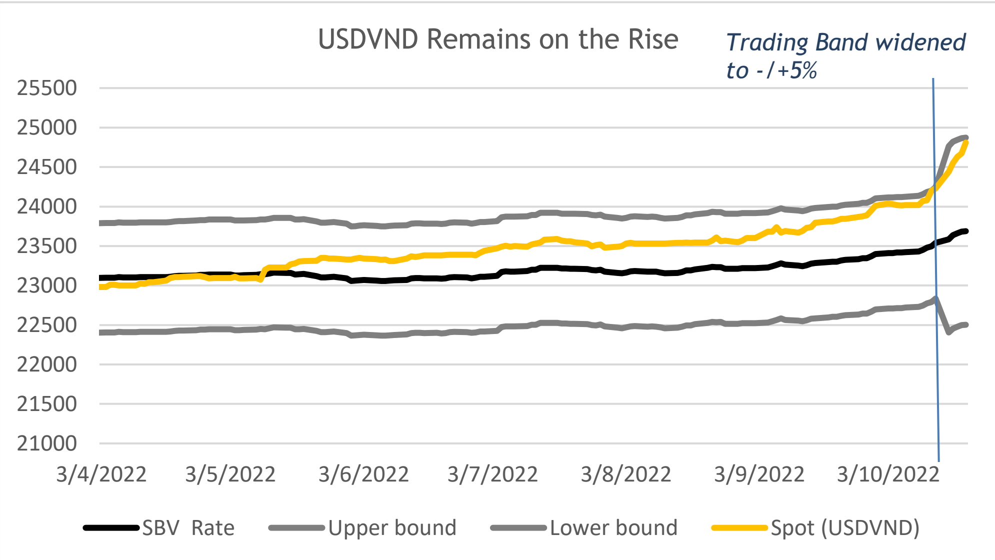
Allowing Market Forces to Drive VND a Tad More

USDVND Forecast Revision

VND has been an outperformer this year, weakening 7.4%ytd (as of 21 Oct) against the USD, ranked just behind the HKD and SGD amongst regional peers. The pace of depreciation against the USD has picked up of late, especially after State Bank of Vietnam (SBV) widened the USDVND spot exchange rate band from +/-3% to +/-5% on 17 Oct. This has allowed more room for USDVND to rise and the VND has weakened 2.2% against the USD since the decision was announced on the morning of Monday. The last band widening was done on 19 Aug 2015 from +/-2% to +/-3% and the last 1% devaluation was also done on the same day.

External forces are at work here against EM currencies, including the VND. US core inflation has beaten expectations for Sep at 0.6%m/m, maintaining its pace from Aug. OIS now imply 75bps hike expected at both the Nov and Dec meetings, a tad more than what Fed's Sep dot plot had projected. Terminal rate (or rather the peak of Fed Fund target rate) is now projected to be 5% by Mar 2023. UST yields rose relentlessly (10y last at 4.25%, 2Y at 4.61%), boosted further by elevated CPI prints from around the world (NZ, UK, EU released earlier this week). Markets seem to acknowledge that this current phase of synchronous monetary policy tightening by major central banks could continue for a while longer in order to ease inflation pressure and more importantly, anchor inflation expectations.

In a backdrop of rising UST yields and USD, SBV has allowed USDVND more room to rise with the widening of the trading band. However, the trading band could be under pressure once again as the spot USDVND reaches the top of the band.



Source: Bloomberg, Maybank FX Research & Strategy, Macrobond

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Daily USDVND Reference Rates Can Be Set with more Market Sensitivity

Part of the limitation of USDVND trading band is the daily reference rates set by SBV. Since the start of 2016, SBV had been setting a daily reference rate for the USDVND to allow the exchange rate to be more market-determined. The methodology is to fix the USDVND reference rate based on a weighted average of dong prices in the interbank market the previous trading day and prices of eight major foreign currencies at 7am (Hanoi). These include the USD, RMB, EUR, JPY, TWD, KRW, THB and SGD.

Based on the historical market movements thus far, USDVND reference rates have been fixed with an inherent dampener. For every 1% move of the USD on average against these currencies ytd (as of 20 Oct 2022), the USDVND reference rate is set only around 0.15% higher. While this may seem small, it is already larger compared to just 0.01% for 2021.

In case of further rise in the broader USD as well as the UST yields, we cannot rule out further adjustments in the sensitivity of the USDVND reference rate to daily market movements of the USD vs the eight major foreign currencies. With greater market sensitivity in the USDVND reference rate, there could be further room in the trading band for spot to react to market forces. On the other hand, in order to provide some support for the VND, our economist now looks for a 100bps hike this year to mitigate the inflationary pressures brought about by rising import costs.

Into 2023, there is an increasing chance for Fed to ease the pace of tightening from current clips of 75bps each. This is especially if inflation shows more signs of easing. Notwithstanding the stubbornly high US core inflation, the latest Beige Book released by the Fed indicated softening in demand conditions and easing of inflation pressure. Of note, even as priority remains on fighting inflation for now, minutes of the Sep Fed meeting revealed that several participants noted the importance of calibrating the pace of further policy tightening with the aim of mitigating the risk of significant adverse effects on the economic outlook. Some calibration could ease USD strength and reduce the pressure on VND.

Our Refreshed USDVND Forecasts

Forecast	4Q 2022	1Q 2023	2Q 2023	3Q 2023
USDVND	25000	24800	24700	24500

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