Monthly Market Commentary

11th July 2008

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JUNE'S STORY

No matter which investment positions you are in, June and early July was an emotional time as the market expressed all possible states in only four weeks: the first week - falling, the second and third week - fluctuating, and the last week - up.

MACRO REVIEW

June 02nd to June 10th: Panic time

We have never received and read as many reports from international and domestic institutions as in late May and early June. Many of those reports showed pessimistic views on the future of Vietnam macro economy based on inflation and trade deficit numbers. The worst opinions predicted a 30% plus depreciation of the VND (Morgan Stanley) and USD30bn annual trade deficit (Mr Phuc - Ministry of Investment and Planning). Standards and Poors, Fitch, and Moody's downgraded Vietnam ratings. Some of these institutions may be over pessimistic but part of the story is true.

- Investors, both domestic and foreign, were worry about their VND assets and tried to convert them into foreign currencies (especially USD) and gold
- Foreign bond holders sold about USD 50mn of G-Bonds everyday at **big discount** (25-26% yield for 5-10 year bonds)

June 11th to June 20th: Mixed signals

- June 11th SBV elevated the base rate another 200 basic points to 14%
- June 18-19th FX rate hit **recorded high at 19.500** in interbank and black market. SBV tightened the USD outflow while demand remained high.
- The Government started a public relation campaign to control people expectation on the country's macro issues:
  - June 20th the Government disclosed FX reserve at **USD20.7bn** and committed not to depreciate the VND substantially
  - Over a billion USD had been injected in to the market within 2 weeks to fulfilled selected import demands
  - High profile Government officers frequently appeared on public media sending positive statements on future inflation, trade deficit, FX market…
- Reports from international institutions World Bank, ADB, HSBC, and Morgan Stanley… provided less pessimistic views on Vietnam macro issues.

June 23rd onward: Making a comeback

- June CPI increased but at slower pace 2.14% vs. 3.91% in May. Expected inflation eased and people started to talk about inflation to peak in few months and then decrease substantially next year
- June trade deficit dropped significantly to **USD1.3bn** from USD2.85bn in May due to tightened USD supply and over USD1bn re-export of steel, fertilizer and fuel
- SBV widened USD trading band from +/-1% to +/-2%, Hundreds of million USD continued to be injected into the banking system to stablized the FX market. USD was traded around 17.200-17.400 at interbank and black market
- The Government sent a message that trade deficit, inflation, and FX are improving and **base rate could be cut in August** if the macro issues continue to be improved
- H1 GDP showed signs of slow down as Q2 growth was only 5.8% against 7.4% in Q1. The growth target for 2008 at 7% seems to be too optimistic given the tightening monetary and fiscal policies. Q2's construction growth was negative.

STOCK MARKET REVIEW

Buyers

We estimated a **40% increased in investors' deposit** at VNDirect over the last three weeks. Our quick survey among big Securities Firms (SSI, BVS, VCBS) confirmed the trend. Roughly estimated, the total amount of fresh money has been over VND 2.000bn (USD 120mn). The main and most active buyers are retail investors (small average size of bids also supported it).

We saw a lot of **new individual investors** who have never trade stocks before. They decided to start investing stocks with a firm belief that the market was already cheap. A further sizable fall is less likely while capital gain is promising for a 1-2 year investment horizon.

Another 1% of trading band expansion to 3% at Hose and 4% at Hastc added more liquidity to the market and attracted a certain amount of **short-term investors** coming back to the market.

While retail investors are quite active and optimistic, most of Funds and Institutional investors we met were cautious. Their strategy was mainly to stay still to wait for more certain signals from the macro economic situation before making any big moves. What they were actively doing last month was to scan the market for potential opportunities, to get the deal sourcing ready for execution, and possibly to restructure their portfolios.

Besides, it's a must to mention that some blue chip stocks (SSI, DPM, PVD, VNM…) were bought aggressively by **foreign investors** since the end of June. Such an activity has supported the market to quickly overcome some tests and corrections at the beginning of July.

Sellers

If we have to choose a single factor which made the comeback for the stock market in the second half of June and early July, it would be the **end of Repo and collateral stocks selling**. We called and met some banks and securities companies to understand the situation. Banks now require borrowers to pay only interests on their loans instead of allowing the loans to be defaulted and selling stock as collaterals. Furthermore, securities companies have successfully collected most of their Repo. As a result, the pressure from Repo and collateral stocks has been reduced at least for the near term.

Besides, improving macro situation and especially lowered pressure on VND depreciation helped to retain investors' confidence. Pressure to sell at huge discount to exit, especially from foreign investors, has decreased.

The indices have decreased roughly 60% since last October, and cutting loss is no longer a strong demand.

WHAT WE EXPECT IN JULY

To be honest, we don't have as much confidence to predict the story of July as we did for June (given that 5 out of 6 predictions came true). The main reasons are lack of reliable information and low predictability of Government policies.

It is obvious that the threat of a sudden collapse in VND value has been reduced significantly as SBV disclosed total USD reserve and macro economic showed initial signs of improvement. Investors have retained a little more confidence. However, **we do not feel that the bottom of macro instability is over** given the remaining pressure on CPI and new threats from banks' liquidity and NPLs.

MACRO VIEW

Inflation

In July and even H2 of 2008, inflation will be the most critical factor to watch. Let's name and weigh factors which will influence July CPI:

Accelerators

- Prices of steel, pharmacy, paper, powder milks, electronics,… have increased in late June and early July
- Gasoline, coal prices will probably raise soon given the price pressure from international market
- VND depreciated about 4% last month => 4% higher import prices in VND term
- Inflation has quickly boosted up globally at historically high level

Decelerators

- Rice price has decreased in both international and domestic market
- Tightening monetary and fiscal policies seem to start taking effect
- Demand of many products and services will drop quickly which prevent prices from climbing up higher

It will be a victory for the Government if they are able rise gasoline price while managing CPI at below 2%. For the rest of 2008, Vietnam CPI will very much depend on global inflation and especially oil price. In the most optimistic scenario, in which oil price will be at current level (145USD/b) until year end, inflation will **peak soonest in September** with YoY CPI at around 30%.

Interest rate

When current and expected inflation stay at high levels, interest rate will less likely to be reduced. Companies and investors will still have to struggle to finance their debts with limited sources of capital at high cost. In the worse case, deposits could decrease which squeezes banks liquidity.

In the last few weeks, the Government has been trying to control expected inflation. It is a necessary, useful, and inexpensive method to stabilize public sentiment and attract more deposit inflows into the banking system (or at least prevent a deposit withdrawal). However, given the possible progress of inflation in the next few months, we think that it is **too early now to talk about base rate cut**. The base rate is needed to be revised appropriately to curb inflation and to ensure banks' liquidity.

From what stated by the Government so far, it's not likely that we will see any base rate change in July.

Trade deficit and FX market

June trade deficit was USD1.3bn, much lower than USD2.85bn in May. At a glance, it seems the Government has managed to control the situation. Let's see what has driven trade deficit down in June and estimate July's figure:

- Tough time for importers: SBV has tightened USD selling in the first half of June which forced importers to buy USD at the market prices which were way above the official rates (19.500 vs. 16.400 at the highest). This situation has been improved substantially in July as the gap has been minimized
- Re-export driven: We estimate that there was over USD1bn of imported products were re-exported in June. Those were mostly steel, fertilizers, and petroleum. It is likely that re-export volume will not be as high as June's volume given the lower inventory and profits
- Domestic demands decreased as a result of tightened monetary and fiscal policies.

In July, USD selling will continue to be tight as only few sectors (petroleum, fertilizers, and export inputs) have priority to buy USD. As a result, imports will not experience strong growth and trade deficit will depend on export performance. A similar or slightly higher trade deficit than last month is the most likely scenario.

So far, the Government has been able to maintain the current FX scheme which minimized the gap between official SBV rate and black market rate. The FX market will be distorted only when inflation or trade deficit are again out of control. **In July, we do not see substantial risks** which could threaten the current FX scheme.

STOCK MARKET VIEW

If macro situation in July will not be so different with June, the balance of current forces will drive the stock market.

Retail investors: They are greedy and bullish. Fresh money from bank deposits both in VND and foreign currencies or from gold investors could continue to enter the market. This flows will deteriorate or switch only when macro economic shows new signs of instability.

Local institutional investors: from our talks with local institutional investors, majority of those who still have cash are ready and intent to buy stocks now. They could be new potential money inflows.

Foreign institutional investors: We have talked to tens institutional investors in the last few weeks. They are cautious about the macro situation and companies' earning potential. We think July alone would not provide much clearance to support their decision making. Some old big funds are selling stocks to restructure their portfolio. SSI, DPM, PVD, VNM…has been bought aggressively; however, available room for foreign investors are narrowing.

Conclusion

Technically, given the end of Repo and collateral stocks selling (at least for now), investors could be confident that there will not be million shares ATO of blue chip stocks everyday as we witnessed in the last few months. So **now it's safer** for investors to enter. However, we recommend that investors should **quickly realize profit** when potential threats become more obvious. Those threats are:

- Rooms for foreign investors are full for blue chip stocks
- Initial signs of shrinking earning growth for Q2 and H1 2008 and worse earning prediction (especially for some specific sectors such as property, construction, banking and financial services)
- Big increase in domestic petroleum price and oil price in international market
- Banks' liquidity is stretched.

For those who thought that they have missed a once in ten years opportunity in the last three weeks, there are still good companies selling at reasonable prices. And if you are patient, **there will be more opportunities** in the coming few months.

Disclamers

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