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Key political risks to watch in Vietnam

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By John Ruwitch

Currencies

HANOI, May 24 (Reuters) - Vietnam reported economic growth of 5.83 percent in the first quarter, but the southeast Asian frontier market is seen as risky and opaque for investors.

Sovereign 5-year credit default swaps VNGV5YUSAC=R are trading at a spread of around 263 basis points, or about 80 basis points higher than those of Indonesia and the Philippines.

Following is a summary of key risks to watch in Vietnam:

* GOVERNMENT EFFECTIVENESS AND TRANSPARENCY

Lack of accountability and burdensome bureaucracy impact the effectiveness of the government in formulating and implementing policy. Economic reform and the restructuring of inefficient state enterprises are vulnerable to being undermined by entrenched interests and conservative elements in government more focused on security, particularly in the months leading up to the Communist Party's 11th National Congress next January.

Analysts say there may be a degree of policy paralysis, or enhanced conservatism, in the coming months as factions and players jockey for position ahead of the congress in early 2011. Important leadership and policy changes generally happen at Party congresses, held once every five years. Local party branches hold individual congresses this year.

As Vietnam continues to make its long transition to a market system, political logic sometimes still appears to trump economic sense, as in the case with a Finance Ministry draft circular on price controls floated late last year. Foreign governments and businesses said it was a step backward and noted that price controls do not work. At the end of April, however, the Ministry sent out a letter brushing such concerns aside in an apparent sign that it would move forward with the law as planned. It remains unclear exactly why.

A separate transparency-related problem is the low quality and uneven quantity of economic data that the government makes public. Economists say this could lead to miscalculations about the health of the economy, and damage investor sentiment.

What to watch:

-- Prime Minister Nguyen Tan Dung has embarked on a plan to trim bureaucratic procedures, and foreign direct investors in particular will watch how that plays out.

-- Investors often list poor infrastructure 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.

-- A crackdown on dissent led to a spike in what Western diplomats and analysts saw as politically motivated court convictions late last year and early this year. This could dent relations with major trade partners including the United States.

* EXCHANGE RATE POLICY

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Vietnam's fixed exchange rate has frequently caused economic pressures to build. The central bank devalued the dong VND in February for the fourth time since mid-2008 to relieve pressure on the currency, and pumped money into the banking system through open market operations. Since then, the gap between unofficial and domestic interbank rates has basically been closed, a sign that pressure has been relieved and risk is abating.

The government has taken a series of other steps to regain control over the currency market, and the central bank has shown a determination to keep forex demand and supply in balance.

In March, however, Fitch put Vietnam's long-term foreign and local currency ratings on negative watch. Fitch argued confidence in the currency was weakening and there was a lack of transparency on economic data. Some economists were puzzled by the timing of the Fitch move, given that currency problems seemed to be abating. But several macroeconomic risks remain.

What to watch:

-- Steps taken by the central bank to curb inflation and bring the trade deficit under control. Some analysts expect a continued orderly weakening of the currency in 2010. In May, however, annual price pressures eased for the second month in a row as food prices eased.

-- The gap between black market dollar/dong rates and interbank rates -- a key gauge of pressure on the currency.

* 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 these efforts lost steam after several journalists were detained for reporting on major scandals. Progress on graft will remain a key determinant of long-term investment attractiveness.

What to watch:

-- Vietnam's rank in corruption perceptions rankings. A strong improvement or decline would influence long-term investment. In Transparency International's 2009 Corruption Perceptions Index, Vietnam's score was unchanged from the previous year, giving it a ranking of 120 out of 180 countries.

* SOCIAL UNREST

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

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.

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-- 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. (Editing by Andrew Marshall)
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