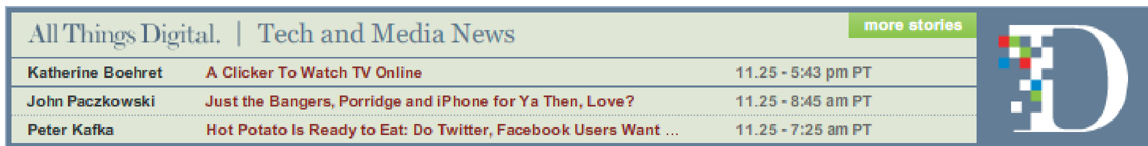

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Vietnam to Devalue Currency, Raise Rates

By VU TRONG KHANH and NGUYEN PHAM MUOI

HANOI--Vietnam devalued its currency and raised interest rates, bowing to market forces that have pressured the dong in an attempt to curb inflation and reduce a drain on the country's foreign-exchange reserves.

The State Bank of Vietnam said Wednesday it will raise the tightly controlled U.S. dollar/dong exchange rate by 5.44% Thursday, setting the dollar at 17,961 dong, up from 17,034 dong Wednesday.

The central bank will also raise its benchmark interest rate to 8% from 7% from December.

This marks the third time in two years that Vietnam has devalued its currency. It follows news that inflation picked up sharply to 4.35% in November from 2.99% in October and comes as the country's trade deficit has widened sharply.

"Inflation is heading higher, which, together with the recent and alarming deterioration in the trade deficit and associated downward pressure on the currency, has finally triggered a policy response from the authorities," said Robert Prior-Wandesforde, an economist at HSBC.

"The response is also most unlikely to be the last," he said, adding the central bank is likely to raise interest rates to 11% by the end of 2010.

Patrick Bennett, foreign-exchange strategist with Societe Generale, said the pressure on the dong has been forcing the central bank to run down its dollar reserves but that the depletion may now become less pressing.

Analysts estimate Vietnam's reserves have fallen to around $16.5 billion from $22 billion at the start of the year.

The central bank also narrowed the trading band of the dollar against the dong to 3% as of Thursday from the current 5%. That means commercial banks won't be able to buy or sell dollars for more than 3% higher or lower than the daily rate set by the central bank.

The State Bank of Vietnam said the changes in the exchange rate are in line with "market signals" and take into account market interest rates, the consumer price index and the country's international balance of payments.

Vietnam's currency has been under pressure partly because of the country's trade deficit. The nation's finance ministry warned late last month that Vietnam is unlikely to cap its trade deficit at $10 billion this year as targeted after hitting $8.7 billion in the first 10 months.

Nomura analyst Yang-Myung Hong said the devaluation probably won't have a significant impact on the cost of protection against default on the country's bonds. Vietnam five-year credit default swaps were quoted flat at 210 to 220 basis points recently.

Mr. Bennett said the moves also won't have any implication for neighboring Asian economies, most of which face appreciation rather than depreciation pressures on their own currencies.

—David Roman and Ditas Lopez in Singapore contributed to this article.

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