Global Economics & Markets Research
Email: GlobalEcoMktResearch@uobgroup.com
URL: www.uob.com.sg/research

Macro + FX Strategy

Vietnam: SBV Widened VND Band In Response To USD Strength And Fed Tightening

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Suan Teck Kin, CFA
Head of Research
Suan.Teckkin@uobgroup.com

Peter Chia
Senior FX Strategist
Peter.ChiaCS@uobgroup.com

- The State Bank of Vietnam (SBV) announced this morning (Mon, 17 Oct) the widening of the USD/VND trading band to 5% from 3%, which was largely in response to the ongoing USD strength and US Fed tightening.
- SBV has in the past adjusted the USD/VND band a few times in response to external developments. Therefore, there is still a possibility that the USD/VND trading bands may be widened further, albeit temporarily, in the event of bigger than expected Fed hikes which adds further upside to the dollar strength. Any additional near-term Fed tightening will reaffirm our expectations of further SBV rate hikes on the horizon by end of 2022 and in early 2023.
- FX Strategy: The increase in the trading bandwidth today confers more space for the VND to fluctuate as it copes with "unpredictable developments" due to a string of monetary policy tightening by global central banks. It is worth mentioning that an expanded bandwidth does not imply that the VND will trade to the weaker side of the allowed trading band. In previous band-widening exercises, USD/VND remains well within the trading bands ex-post.

USD/VND Trading Band Widened to +/-5%

The State Bank of Vietnam (SBV) announced this morning (Mon, 17 Oct) the widening of the USD/VND trading band to +/-5% compared to the previous +/-3% from the reference rate, effective immediately. After the announcement, spot USD/VND jumped from 24,128, to record high of 24,253 by noon, an increase of 0.5%, which is a large move considering that the pair moves by around 0.1% to 0.3% in a normal day.

The announcement was largely in response to the ongoing USD strength brought on by an unrelentless US Federal Reserve, which is poised to deliver another jumbo rate hike at the next policy meeting on 1-2 Nov (For more details please refer to US: Core CPI Inflation Rose To A 40-Year High Of 6.6% in Sep, Cementing Expectations For Another Jumbo Hike In Nov FOMC, 14 Oct 2022).

Bloomberg News reported that SBV said it made the adjustment "in order to proactively cope with unpredictable developments in the international market" and the tightening of monetary policy by the US Federal Reserve and other central banks.

The widening of the trading band allows for more flexibility for the VND to move against the reference exchange rate, and with the current strong USD backdrop, that could potentially mean further room for depreciation of the Vietnamese dong. YTD, the dong has weakened 6% against the USD, a relatively moderate pace considering that the US dollar index (DXY) has gained 18% so far in 2022, while the Asian dollar index (ADXY) has fallen nearly 11% to date.

Risk Of More Band Widening Ahead?

SBV has in the past adjusted the USD/VND band a few times in response to external developments. Prior to the current move, SBV widened the trading band to 3% from 2% on 19 Aug 2015 following the devaluation of the CNY, when China announced further currency reform to make its exchange rate more market oriented. Just one week prior to that, SBV had widened its trading band to 2% from 1% on 12 Aug 2015.

As the US Fed is expected to continue to pursue the tightening of its policy in the months ahead, and market volatility is likely to remain high and USD staying on the strengthening bias.

The SBV has earlier surprised the market with a 100bps hike to its policy soon after the Fed's decision in Sep (for more details: Vietnam: A Surprise Early Start To SBV Policy Normalization Cycle, 23 Sep 2022).

Therefore, there is still a possibility that the USD/VND trading band may be widened further, albeit temporarily, in the event of bigger than expected Fed hikes which adds further upside to the dollar strength. Any additional near-term Fed tightening will reaffirm our expectations of further SBV policy rate hikes on the horizon by end of 2022 and in early 2023.

FX Strategy: VND To Track Broad Asia-FX Weakness

Despite strong domestic fundamentals, the VND is not spared from the broad-based Asia FX rout of late triggered by further front-loading of Fed rate hikes. In fact, the VND weakness appears to pick up pace after the spot rate weakened past the psychological 24,000 level against the USD last Thu (13 Oct), post a stronger-than-expected US inflation print.

The increase in the trading bandwidth today confers more space for the VND to fluctuate as it copes with "unpredictable developments" due to a string of monetary policy tightening by global central banks. At the same time, it is worth mentioning that an expanded bandwidth does not imply that the VND will trade to the weaker side of the allowed trading band. In previous band-widening exercises, USD/VND remains well within the trading bands ex-post.

Overall, VND's increasing correlation to a weakening CNY - one of Vietnam's key trading partners – keeps the VND biased to further downside against the USD. The volatility in the FX markets has driven USD/VND beyond our end-2022 forecast of 24,000 and towards our 3Q 2023 forecast of 24,300. We are in the midst of reviewing our FX forecasts and will be publishing the latest after the next FOMC meeting in early Nov.

Vietnam: Evolution of USD/VND reference rate and trading bands

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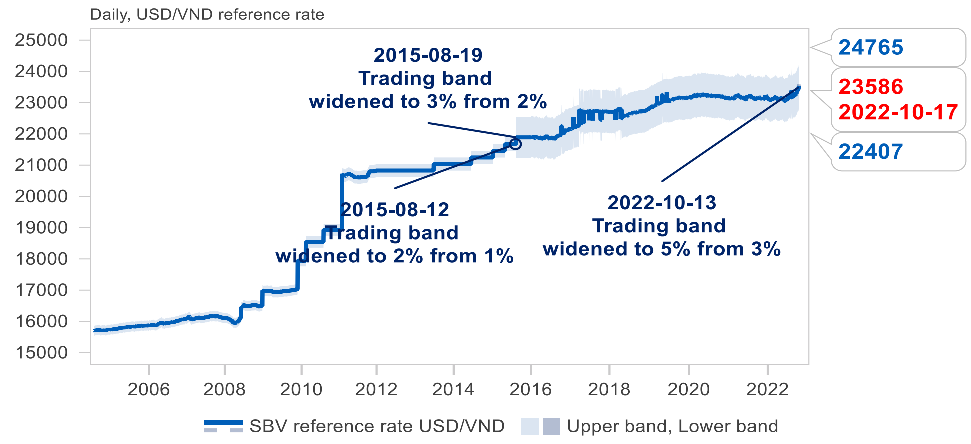

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