Photo by Thiên Triều

HOW TO COOL THE STOCK MARKET

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1. What make the stock market so hot?

Some people are of the opinion that the main cause is the presence of foreign investors. But estimates given by these investors couldn't be validated. Those who come first always spread rumors, discreetly of course, and sometimes they are supported by local experts, with a view to discouraging late comers. Many local investors also blame foreign rivals for the bubble in the stock market while the latter said the cause is the craziness from local investors. Lot of information and remarks that nobody could verify have made stock market authorities and observers confused. And the capital control as an instrument for limiting the flow of foreign capital is the easiest solution to think of when being confused. Some people support it and some others protest, and many of them only think of their own interests or only cling to their own viewpoints.

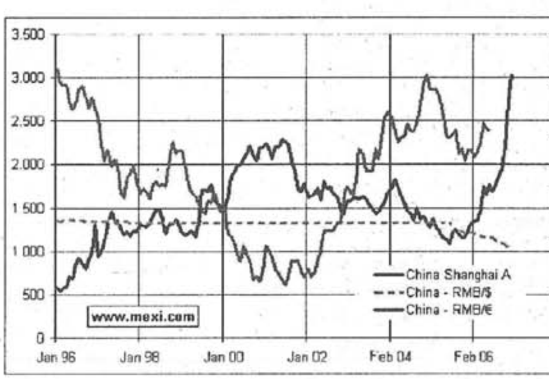
As we usually find in a detective novel, first characters usually are not the real culprit, and the unexpected often come from the most ordinary persons. The main cause might be the poor coordination between Ministry of Finance, the SBV and State Commission of Securities in running and supervising the market. Or it might be caused by loopholes in financial and monetary policies that allow commercial banks have their stockbrokers invest in shares with money from the banks; or allow a high exchange rate of the VND to the dollar. When the exchange rate to the dollar is high, the capital inflow is only used for doing some arbitrage. The danger lies in the fact that foreign investors have the right to transfer their capital and profit to their home country. The increasing capital outflow can make the bubble burst.

If the main causes for the bubble in the stock market are the loopholes in the policies that the authorities fail to detect, the situation will be very worrying and not as normal as described by a high-ranking official, "We are nor afraid of a hot stock market."

If authorities introduce strong measures in haste without analyzing all causes of the situation, from the most obvious ones in market forces to the most obscure ones in the policies, the stock market will be affected badly.

The following chart about the Chinese stock market in its hot development shows many similarities between the Chinese and Vietnamese ones. In both Vietnam and China, the stock market gets hotter after a long period of stable exchange rate.

Figure 1: Price of the Shanghai A stock and exchange rates in 1996-2006



2. How to cool the market

Generally, experience from the American, Hong Kong, Chinese and Taiwanese markets shows that there are two basic measures the government can take to intervene in a market in its "hot development": employing monetary instruments (increasing the interest rate, reducing bank loans, limiting the money supply, etc.); and giving market warnings. Another measure that could be theoretically taken by authorities is to buy or sell shares on the market to stabilize the price. However, governments only resort to this measure because speculators sell shares in large quantities (as happened in Hong Kong in 1998), not in case of hot development.

Researches in different markets show that intervening measures produce only short-term results, and the less effective in regulating the market the government is, the bigger its failure to produce long-term results. Moreover, it is more difficult to intervene in the market using monetary instruments because the government should deal with the whole economy. For example, the government can raise the interest rate to slow down rises in the share price but it should consider the possibility of economic recession caused by a higher interest rate. The U.S. is a typical case of this approach.

Another factor that should be taken into account is resilience of the market. In other words, when money is poured into the stock market, most people think that "here is a bubble but you can still buy," that is, they agree that the development is a bit too hot but they believe that the future is bright, the bubble is to be bigger and last for some more years. That is why they keep putting their money in shares as seen in the "golden decade" in China. In Vietnam today, there are many people who think that they may make easy money in years to come. With such a mentality, the bubble will keep getting bigger regardless of warnings from authorities and experts. Of course, to a certain point, the bubble will burst and the market collapse.

Although the market may get cooler because of self-adjustment or effects caused by the authorities, or it may collapse, major investors can always stand on their feet and they can even buy more shares when the price falls and wait for a brighter future. Only small and less- experienced investors suffer great losses or even get out of business. This means that whether the government takes measures to cool the market or not, small investors are always the loser. The only difference is the fact that the market may get cooler be degrees when the government intervenes, otherwise it may collapse.

Thus, the problem is whether the economy endures such hot increases in the stock price or not. If the economy doesn't slow down, the stock market will keep getting hot as seen in China, regardless of government interventions. In 2006, the mass media carried many articles about "safe landing" and "unsafe landing" in China, and finally, the most exact model was "no landing at all."

Researches in the cooling experience in Taiwanese stock exchange show that if market warnings are given continuously, or all trading sessions are delayed temporarily, three abnormally hot factors (extreme instability, unreasonable profitability and excessive liquidity) will reduce, which is very favorable to small investors.

Such measures and IMF recommendations (of course we should be cautious about carrying them out) are precious lessons to the local stock market. Moreover, the following solutions are worth taking into consideration.

- Increasing the supply of commodities: Selling shares of the SCIC, promoting IPOs, and attracting more money from the primary market are very helpful measures.

- Consulting participants in the market: These participants are issuers, investors, Brokerage firms, commercial banks, etc., and they may understand what are happening behind the scenes and what the nature of these happenings are. Is it necessary to use administrative instruments to cool the market before determining the causes of the recently hot development?

- Identifying the role of the state investor: It's strange to hear the Chairman of the Board of Directors of the SCIC announce that they have no function of stabilizing the market prices by selling or buying shares. Nobody bans the SCIC – the biggest investor of the State – from giving cooling signs even if they are under no obligation to carry out what they say. Fortunately, the Government has recently announced that it would sell part of its shares in the SCIC to deflate the bubble to some extent.

- Controlling profit in the capital outflow: If the situation is really urgent (of course it will have a long way to go before reaching such a crisis as the 1997 one), it is not necessary to impose control over the capital inflow as long as the inflow is small enough. The government had better negotiate with foreign investors about process of transferring their profit out. Investors who want to do long-term business in Vietnam will understand what the Government wants. Only speculators may disagree but their presence in the stock market is not welcome.

When imposing the capital control, it's necessary to pay attention to the "non-retroactive principle." This means that the past inflow won't be put under the control imposed by authorities in the near future. Failure to observe this principle may discourage many foreign investment funds that have been operational in Vietnam in the past few years.

3. As a conclusion

Whatever measures are to be taken, the most important task is to protect small investors. The most fundamental solution that ensures an exit for small investors includes enhancing the size and transparency of the official market; improving the mechanism for taking and matching orders; working specific rules of the OTC market; and encouraging the development of mutual funds in order to reduce the number of small and unprofessional investors. Besides providing them with necessary knowledge and information needed for self-protection, some losses could be seen as a kind of tuition fee for those who are too greedy for high profitability ratio. Speculation is common in any stock market. Vietnam can't open its market if it rejects this phenomenon. Imposing limits and prohibition is never a proper solution unless the crisis is around the corner ■