SOME OPINIONS ABOUT THE INTERBANK FOREIGN EXCHANGE MARKET

by MEcon. NGUYỄN THỊ THÚY VÂN & TRẦN THỊ VIỆT THU

Operation of two Foreign Exchange Transaction Centers as tools for controlling the exchange rate by the central bank has revealed many shortcomings (small membership, small transaction volume, poor liquidity, etc.). That is why we need an interbank market acting as both a money and a foreign exchange markets where domestic and all foreign currencies could be traded. The main difference between an interbank foreign exchange market and a foreign exchange transaction center is the fact that all transactions in the interbank market are made through telecommunications, instead of on the floor of the transaction center. The interbank market has started to create conditions for banks to solve their surplus or shortage of foreign exchange.

Up to 1994, the operation of interbank market became brisker but it failed to reflect the relations between supply and demand forces. In addition, the central bank couldn't control strictly all markets with the result that it met with difficulties in regulating the interest rate, exchange rate and changes in the money supply.

In 1995-96, the supply of foreign exchange exceeded the demand, especially after the issue of Decree 36/CP establishing the Vietnamese đồng as the only legal tender in Vietnam. The operation of the interbank fell into the doldrums because most commercial bank didn't get enough domestic bank notes to buy foreign currencies. This situation required the central bank to intervene to prevent the value of domestic currency from rising.

In 1997, the interbank market entered a long period of stagnation because of the Asian financial crisis. It was reduced to an office informing dealers of the official rate and had no ability to control and regulate supply and demand forces. Generally, the transactions velocity was low because most banks didn't want to keep large amounts of the unconvertible domestic currency or engage in the interbank payments system.

Thus, the operation of the interbank market in recent years failed to reflect changes in the supply of, and demand for, foreign exchange. In addition, the central bank's role in this market was badly played. The main reason was the fact that there are only one-way transactions in the interbank market. When the export business is brisk, companies earn a lot of foreign exchange and they sell it to commercial banks which, in their turn, will offer for sale on the interbank market and the central bank has to buy it to keep the exchange rate stable. And when companies need foreign exchange, commercial banks can't provide them with it because it's hard to buy foreign exchange from the central bank through the interbank market.

For a long time, there has been almost no relation between the exchange rate and the interbank market because the exchange rate has been kept fixed and the interbank market was only a buying agent for the central bank.

On Feb. 25, 1999, the central bank made Decisions 64 and 65 using the average exchange rates on the interbank market as the base rate with a wide band of 0.2% (or a narrow band of 0.1% on either side of the base rate) within it all transactions could be made. Thus, a great change happened then: the central bank accepted the effect of market forces on the exchange rate. But the question was how this base rate was worked out.

There are two kinds of transaction on the interbank market:

+ Transactions between commercial banks and the interbank market with the exchange rate fixed by the central banks.

+ Transactions between commercial banks with the rate agreed upon by the parties.

The exact calculation of the average exchange rate is important to application of the new exchange rate mechanism. If information about the rates agreed upon by commercial banks isn't timely and exact, the average exchange rate worked out will be only a rate agreed by the central bank and some of its customers, that is, this rate doesn't reflect all rates used by commercial banks.

Another problem is that the supply of foreign exchange on the free market tended to increase when the central bank required all companies to sell 50%, instead of 80% as in the past, of their earnings in foreign exchange to commercial banks. However, the exchange rate didn't change much because the central bank bought all the surplus of foreign exchange on the market. That is why the exchange rate of the VND to the USD fell very slowly (only by 0.51% in the first eight months of 1999).

In short, the central bank should regulate the exchange rate more flexibly and opportunely in order to make the operation of the interbank market brisker■