

# NECESSARY AND SUFFICIENT CONDITIONS FOR INTEREST RATE LIBERALIZATION

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A rarely different characteristic of Vietnamese banking activities in comparison with other countries in the world is that commercial banks trade in both local currency – Vietnamese đồng and foreign ones – mainly U.S. dollar. That implies they receive deposits, mobilize capital, offer loans, pay required reserve and make other pay-

tiative in making prompt decisions on daily and hourly activities in accordance with changes in the money market. Moreover, it also deals with relations between local currency and foreign currency in case of glut or shortage of Vietnamese đồng and U.S. dollar. For commercial banks, Vietnamese đồng has really appreciated in recent months, U.S. dollar

financed by local commercial banks, including Cà Mau gas-electricity-fertilizer complex, Phú Mỹ thermopower, South Côn Sơn gas pipe, Na Dương thermopower, Sê San hydropower, Tam Điệp cement, etc., increases. However, the interest rates of deposits in U.S. dollar still see insignificant rise. At the same time, the exchange rate between Viet-

tions of experienced bankers.

The deposit rates have gone up right from January 2002, but until mid-April 2002, when all commercial banks promoted the interest rates of deposits in Vietnamese đồng to the maximum since the SBV announced the basic interest rate (August 2000), it actually resulted in bankers' worry.



ments... both in Vietnamese đồng and U.S. dollar. Some state-owned commercial banks have the percentage of assets in foreign currency higher than that in local one, amounting to 65%-70%. The proportion of mobilized capital in foreign currency of commercial banks in Hà Nội and HCMC has often reached over 40% of the total attracted capital in recent years. As a result, in its business management, a commercial bank or branch must hold the ini-

has seen no change in value, and the basic interest rate announced by the State Bank becomes insignificant, so it seems to be floated.

Concerning the interest rates of deposits in foreign currency, the State Bank of Vietnam reduces the proportion of required reserve ratio to 8%, and the interest rates go up slightly in the international market. At present, the demand for loans in foreign currency to large projects which are co-

named đồng and U.S. dollar only rises slightly. In early January 2002, the exchange rate in the interbank market was VND15,093 to a dollar and VND15,125 in the free market. But in late April 2002, these figures climbed to VND15,208 and VND15,235 respectively. The growth rates are 0.76% and 0.73% in four months. In the meanwhile, the interest rates of Vietnamese đồng soared continuously beyond expecta-

In particular the Vietnam Foreign Trade Bank (VCB) is always the bank usually having the largest disposable capital and glut of Vietnamese đồng capital for loans in the money market but it has instructed all its branches not to give loans to other banking institutions. In the meantime, from April 24, 2002, it had to increase the deposit rate by 0.03% for all terms. For example, the deposit rate is 0.58%/month for 3-month term; 0.60%/month for 6-



month term; 0.63%/month for 9-month term and 0.65%/month for 12-month term. In April 25, 2002, the Vietnam Bank for Agriculture and Rural Development announced the issuance of 12-month bonds in its 28 branches in most big cities and provinces having potentials in capital mobilization. The bond has a prepaid interest rate of 0.65%/month, equivalent to 7.05%/month. This rate is much higher than that of other commercial banks.

The maximum deposit interest rates of large and influential commercial banks have defeated other commercial banks, especially joint stock banks in this trend of asymmetric competition.

To intervene in very hot development of the money market, since late April 2002, the central bank has decided to increase the number of trading sessions of the open market to two every week. This will produce effects on disposable capital of commercial banks and create conditions for banks to utilize their capital positively, flexibly and effectively by selling short-term valuable papers to the SBV with the aim to get Vietnamese đồng capital. Only in the first quarter of this year, by managing the open market, the central bank purchased the volume of bonds worth VND3,297 billion, higher than the total in 2001. The purchase in April also reached VND1,000 billion. Accordingly, just in the first four months of this year, by this practice, the SBV supplied some VND4,000 billion to commercial banks while in the first six months of 2001; its money supply was nothing. In addition, by practicing Swap, the central bank has also provided some VND2,500 billion for commercial banks. The market for T-bill bidding remained very flat in April; there was almost no buyer. In fact,



there was only the Vietnam Foreign Trade Bank winning the bid worth VND40 billion in a session.

The current problem is commercial banks' capital in local currency is still badly needed. If depending on the State Bank, there are only two sources. The first is to sell short-term valuable papers in the open market, but they have exhausted bills of the SBV and the Treasury. The second is to swap U.S. dollar with the central bank to receive Vietnamese đồng for giving loans. However, their greenback stock is not abundant, the swap interest rate is very high and thus discouraging commercial banks. Moreover, the SBV's money supply is restricted due to fear of inflation.

In addition, the deposit rates for terms longer than 6 months become higher than the basic interest rate of 0.6%/month. Because of the tense situation of local currency capital and interest rate, the Industrial and Commercial Bank of Vietnam has instructed its branches not to offer loans with interest rates under 0.62%/month since April. Other commercial banks have also lent money with interest rates over 0.62%/month. Meanwhile, in principle, the central bank deter-

mines and announces the basic interest rate on the basis of lending rates of 15 large commercial banks. Therefore, if the basic interest rate of 0.6% announced by the SBV since November 2001 remains unchanged, it will be obviously unrealistic and insignificant to the market. In addition, the interest rate of current T-bills is now 0.65%/month, far higher than the basic interest rate. As a result, if the SBV determines the basic interest rate close to the reality, that means it increases the lending rate while the Vietnamese economy has grown slowly as compared to the same period last year and the business performance of enterprises and farmers is not high.

The evidence shows the interest rates of local currency are nearly liberalized. That is agreed interest rates in accordance with the Resolution of the fifth meeting of the Party Executive Committee, Term IX. The only difference is that the central bank has not yet recognized it. Furthermore, the interest rate of loans in foreign currency has been liberalized since June 2001; the SBV stipulates only interest rates of legal entities' deposits in U.S. dollar.

The monetary policy targets at speeding up eco-

nomic growth rate and controlling inflation, and more widely generating jobs. The facts of current Vietnamese economy as well as changes in the money market indicate the central bank is required to employ management instruments including reserve requirement, capital reallocation loan, rediscount... more positively and flexibly. In addition, the national economy depends not only on the SBV's performance, but also on the Government's policies on finance and investment and control over the real estate market.

In such a situation, if commercial banks do not tighten credit and reject enterprises' demand for loans, their lending rates must increase. This will be a great concern of business people; especially those operating mainly by taking bank loans while their sales and profits see no bright signal.

The facts of the central bank's management, commercial banks' business performance and changes in the money market show there are enough conditions for the central bank to change into indirect management of interest rates in accordance with the common trend of other countries in the region and the world. ■