

# Employing Interest Rate in Vietnam in Current Period

an interview with Dr. Lê Xuân Nghĩa

*Editor's note: The anti-inflation tight-money policy has made the interest rate rise and the exchange rate to the dollar fall. This situation has caused a lot of difficulties to companies, especially exporters. To help companies acquire exact analyses needed for their business decisions when facing complicated changes in the inflation rate, the EDR has conducted an interview with Dr. Lê Xuân Nghĩa (LXN), head of the SBV Department of Banking Development Strategy. The following are his opinions.*

**EDR:** *The interest rate on loans in the domestic currency has had its ceiling now. How about the interest rate on loans in foreign exchange?*

**LXN:** The interest rate on deposits in foreign exchange has become much higher recently. The race at this time is no less keen than the previous one conducted by the interest rate on loans in the domestic currency. As for loans in foreign currencies at the same time, the short-term rate is also higher than the long-term one, which was started by minor commercial banks and predicted by some economic analysts. Basically, increase in the interest rate on loans in foreign currencies is an inevitable result of the increase in the rate on domestic-currency loans and appreciation of the VND. If the rate on deposits in foreign currencies varies from 6.0% and 6.5% a year, the lending rate must be 10% or 10.5%. What will happen to companies? We can hardly imagine that companies turn bank loans into investments. They can only use them to import consumers' goods, farm materials, pharmaceuticals or some building materials whose prices are on the increase. Those who borrow money from banks at present may include minor banks who suffer shortage of foreign exchange caused partly by increases in the required reserve for deposits in foreign currencies. It will be very lucky if this situation is only an after-effect of the recent monetary shock. And if the shock lasts longer, its consequences are no less disastrous, or even worse than ones caused by the rate on loans in the domestic currency because the exchange risk when the price of the dollar rises strongly



is very high.

**EDR:** *Do you think the present interest rate of the domestic currency is too high?*

**LXN:** At present, the rate on domestic-currency loans has reached its ceiling of 12% and the lending rate amounted to somewhere between 18% and 20%. This rate is too high for companies but it is the price for effort to curb the inflation. For the time being, there are two key measures to keep the inflation rate under control:

(1) adopting a dear-money policy, which leads to higher interest rate and lower exchange rate to the dollar (both consequences produce bad effects on investment and export); and (2) Cutting public expenditure to the bone, especially public investment, by getting rid of unproductive and inefficient projects and accelerating profitable ones. In Vietnam, however, the second measure may cause great troubles for state-owned companies because most state-invested projects are carried out by them. It is not easy to overcome this obstacle because of its political after-effects. Thus, the cut in the public investment is still an urgent and important issue that requires longer time to carry it out.

In other words, a dear-money policy seems the easiest and most effective measure to struggle against the inflation under current condition, although this means a lower growth rate and modest results if it is not linked with other measures.

**EDR:** *Is there, in your opinion, any other measure to cut the interest rate?*

**LXN:** The biggest difficulties to companies at present are increases in prices of factor-inputs, high labor cost and interest rate and they must face these challenges for the time being. The best solution is not a call for help but a major cut in their production cost, especially expenses on fuel, energy and labor. This means that each company should work out a medium-term plan, not a short-term one, to save its fuel, materials, labor and energy. At the same time, companies should review their investment projects and get ready to delay or cancel projects whose profit has

become lower than present opportunity cost. If such measures (dear-money policy and cuts in costs) are carried out properly, the inflation rate may partly reduce within a quarter, and then chances to lower the interest rate may make their appearance. If administrative measure is taken to cut the interest rate, the invisible hand will certainly make the inflation rate go higher.

**EDR:** *So, in your opinion, targets of a high growth rate and a low inflation rate are no easy tasks.*

**LXN:** That's right, to maintain a growth rate of 8.5% or 9.0% and keep the inflation rate lower than the last one seem unattainable this year. That is why we should adjust our target and content with a lower growth rate, and at the same time we should consider a low inflation rate as a medium-term target, that is, it will take us several years to reduce the inflation rate to a level lower than the growth rate. What is important to the struggle against the inflation is how to generate a downward tendency of the CPI. This is of important meaning to public mentality and confidence in the government's macroeconomic management. I think the inflation rate in 2008 may be higher than the 2007 one because increases in the total amount of legal tender and credit supplied in 2007 were very high (43% and 54% respectively). With an usual latency of one year, the expected inflation rate in 2008 may be rather high. Thus, it's reasonable to expect the inflation rate to decrease gradually month by month. If we want to reduce the inflation rate quickly, we should introduce a higher interest rate and accept a lower growth rate.

**EDR:** *Will the SBV apply a limit of 30% on credit growth of each bank as rumor has it?*

**LXN:** I don't think it is a good measure. The 30% limit on the credit growth can only be seen as a target for the SBV in controlling the money supply. It is not only an obsolete administrative measure contrary to reform targets, but also an ineffective and unfair measure. It is contrary to the law of "economies of scale" and brings commercial banks to a dilemma. For example, a low capital adequacy ratio (from 6% to 7%) is common among major commercial banks now, so their business may be riskier if their credit supply rises by 30% without an according increase in their equity capital. On the other hand, this ratio is higher in minor banks (from 10% to 15%), which allows them to increase their credit supply by a rate higher than 30%, not to mention newly established banks where this ratio is very high.

Some people are of the opinion that it is a Chinese experience, but perhaps they forget that most Chinese

banks are state-owned ones. The Bank of China sets both interest rate and credit limit, which is not appropriate to conditions in Vietnam.

**EDR:** *It seems that the SBV has employed more administrative measures than economic instruments. What can you say about it?*

**LXN:** Regrettably it's true. These measures include the required reserve ratio, compulsory T-bills, and Decision 03 on credits for investors in stocks, and ceiling rate of interest. This means that common instruments for the monetary policy, such as open market operation, and discount, etc., and supervision mechanism are ineffective, and at the same time, it proves that the inter-bank market is underdeveloped and SBV interest rate lacks its regulatory effects. When the flow of capital to the finance market rises suddenly, some monetary instruments prove ineffective with the result that the SBV has to employ administrative measures. If this practice is not adjusted to the size, subtlety and fluctuations of the finance market, the risk of macroeconomic instability is very high. This situation shows that the international integration is a great challenge to companies' competitiveness and the government's macroeconomic management as well.

**EDR:** *Can you tell us more about the SBV implementation of its monetary policy and the interest rate in months to come?*

**LXN:** Principal objectives for the SBV at present are to control the inflation and protect the liquidity of the banking system when facing complicated fluctuations in the international finance market. However, the struggle against the inflation should not be carried out hastily and measures to reduce the supply of credit should not be done strictly. The SBV should make adjustment carefully, with a step-by-step approach with a view to avoiding bad effects on liquidity of commercial banks and realty and stock market. If these markets (especially the realty one) collapse, a crisis in the banking system is inevitable and then the struggle against the inflation will become meaningless. We are struggling against the inflation when bubbles exist in the realty market, the trade gap is huge, the stock market is in the doldrums, the financial sector faces various problems and particularly, an American recession and disorder in the international finance market are looming up. Thus, a package solution as directed by the PM is desirable and implementation of the solution, and the monetary policy in particular, should be carried out carefully, cleverly and timely.

**EDR:** *Thank you very much. We wish you good health.*