INTEREST RATE AS AN INSTRUMENT FOR TAPPING SOURCES OF MEDIUM- AND LONG-TERM CAPITAL

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Three different interest rates are charged according to the term of the loan: short-, medium- and long-term rates. In Vietnam, however, sources of long-term capital are very limited, so there are only two rates: short- term, and long- and medium-term ones. In addition, most economists agree that the longer the term the higher the interest rate because of the degree of risk involved.

1.Supply of medium- and long term loans in Vietnam

Before July 15, 1996, the medium- and long-term rate was always lower than the short-term one, therefore all commercial banks were reluctant to supply medium- and long-term loans because long-term loans brought in lower interest and bigger risk, and moreover, commercial banks couldn't find out sources of long-term capital.

In addition, it seemed as if the central bank paid no attention to the supply of medium- and long-term loans by commercial banks, and companies didn't need long-term loans to improve product quality and competitiveness.

On July 15, 1996, the central bank, by issuing the Decision 191-QĐ/NH1, made the medium- and long-term interest rate higher than the short-term one (1.65% a month as compared with 1.60%). The difference of 0.05% a month, or 0.6% a year, between them wasn't big but it could encourage commercial banks to start supplying medium- and long-term loans.

On August 27, 1996, the central bank reduced the long-term lending rate to. 1.55% a month and the short-term rate to 1.50% (the difference was the same). On Sep. 27, 1996, the central bank, in its Decision 266-QĐ/NH1, increased the difference to 0.10% a month, or 1.2% a year (1.35% minus 1.25%). And after that, the central bank, by issuing the Decision 197-QĐ/NH1 on June 28, 1997, reduced al interest rates but the difference between the long-term rate (1.10% a month) and the short-term one (1.00%) was kept unchanged. In this period, all commercial banks supplied more medium- and long-term loans because the demand for them increased remarkably. These meant that many companies were able to increase output, import new technology and improve product quality and competitiveness. Realities in 1997 showed that many locally made products were more saleable than imported counterparts, and export value became higher than import value, thereby reducing both trade gap and deficit in the balance of international payments (see Tables 1 and 2). Particularly, in bank credit supply, long-term loan increased faster than the short-term one (32% in comparison with 20.5%)

the difference between the medium- and long-term lending rate (1.25% a month) and the short-term rate (1.20%) was reduced to 0.05% a month, or 0.6% a year. This fact makes us wonder whether commercial banks will keep on supplying medium- and long-term loans in 1998 or not. (see table3 next page)

The resolution made by the VCP Central Committee of the 8th term in its 4th conference said that " (we must) accelerate the economic reform, make the best use of internal strength, improve international cooperation, and save up for industrialization and modernization in order to achieve all aims planned for the year 2000". To maintain high growth rates constantly and steadily in years, Vietnam must make enormous investments while both government and private investment made every year is small. That is why all companies have to depend on banks for medium- and long-term investment. But, as was

Table 1: Import & Export in 1996-97 (US$ mil.)

	1996	1997	Growth rate
Import value	11.144.0	11.200	0.50%
Export value	7.255.8	8.850	21.97%
Trade gap	3.888.2	2.350	

Source: *Thời Báo Kinh Tế Việt Nam*

Table 2: Balance of Payments in 1996-97 (as % of GDP)

	1996	1997
Balance of trade	-13.4	-8.3
Balance of payments on current account	-11.2	-5.5

Source: *Thời Báo Kinh Tế Việt Nam*

However, according to the Decision 39/1998/QĐ-NHNN1 issued on Jan. 17, 1998 by the central bank, stated above, the low lending rate, especially the medium- and long-term one, leads to the low deposit

Table 3: Adjustments to the Ceiling on Lending Rate in 1996-98 (% per month)

	July 15, 1996	Aug. 27, 1996	Sep. 27, 1996	June 28, 1997	Jan. 17, 1998
Short-term rate	1.60	1.50	1.25	1.00	1.20
Medium- and long-term rate	1.65	1.55	1.35	1.10	1.25
Difference	0.05	0.05	0.10	0.10	0.05

Source: Vietnam State Bank

rate, and as a result, commercial banks can't secure medium- and long-term capital to supply medium- and long-term loans.

2.Medium- and long-term capital of commercial banks

According to the central bank, commercial banks are facing many difficulties in mobilizing medium- and long-term capital because of the following reasons:

-Capital accumulation is slow, and savings are small.

-Value of the domestic currency isn't stable; the exchange rate is changeable, so the public is reluctant to deposit money with banks.

-Regular adjustments to the ceiling on lending rate make both commercial banks and depositors lose all interest in medium- and long-term loans.

-Instruments for mobilizing long-term capital and a secondary market are still lacking.

Although effects of interest rate on the capital accumulation are recognized, the central banks has failed to control the interest rate in a way that could help commercial banks attract long-term deposits and create necessary instruments for mobilizing long-term capital while the need for it has been very great. Many commercial banks have had to turn some 20% of short-term deposit to long-term loan. This measure can't be taken for long and the central bank had better not encourage commercial banks to do it because it can harm the bank's solvency.

At present, HCMC banks offer the following deposit rates:

Table 4: Deposit rates offered by banks in HCMC (March 1998)

3-month	6-month	9-month	12-month	24-month
0.85%	0.90%	0.95%	1.00%	1.05%

The data show that the medium-term deposit rate isn't attractive because the difference between interest rates paid for 12-month and 24-month deposits isn't bigger than the difference between other kinds of deposit (all differences are 0.05% a month).

As for banks, if they pay a 1.00% interest rate to a 12-month deposit then the interest rate after making 10% required reserve will be 1.11%. This means that the interest rate on 24-month deposits is lower than on 12-month deposits because the bank isn't forced to keep reserve for 24-month deposits. Income-conscious depositors will think that banks cut down their income when they make 24-month, instead of 12-month, deposits.

Table 5: Suggestions about higher deposit rates

	3-month deposit	6-month deposit	9-month deposit	12-month deposit	24-month deposit	36-month deposit
Current deposit rates	0.85%	0.90%	0.95%	1.00%	1.05%	
Solution 1	0.85%	0.90%	0.95%	1.00%	1.10%	1.19%
Solution 2	0.85%	0.90%	0.95%	1.00%	1.15%	1.24%
Solution 3	0.85%	0.90%	0.95%	1.00%	1.20%	1.29%

The Table 5 suggests three solutions to the interest rate on 24-month deposits. If the Solution 1 is adopted, the interest rate offered (1.10% a month) will be lower than the interest rate on 12-month deposit after the required reserve is met (1.11% a month); therefore it isn't attractive. With the Solution 2, the bank will pay an interest rate of 1.15% to 24-month deposits, 0.04% higher than the interest rate paid to 12-month deposits. If the bank adopts the Solution 3, the difference between those two interest rates will be 0.20% a month and the interest rate will be 1.20% a month. It is acceptable to most depositors.

As for banks, with the Solution 3, they will have to pay an extra interest rate of 0.09% (or 1.20% - 1.11%) when the required reserve isn't taken into consideration. Regarding the 36-month deposits, the deposit rate will be 1.29% a month but the bank can't pay it because it is higher than the ceiling set by the central bank.

In spite of the difficulties in mobilizing medium- and long-term capital, the central bank has set the following targets for commercial banks in 1998:

-Medium- and long-term capital represents some 15% of the total capital mobilized.

-Up to Dec. 31, 1998, medium- and long-term loan must represent 34% of the total bank loan.

-Medium- and long-term loan increases by 22% in comparison with 1997.

These targets seem out of reach for commercial banks because the only way for them to achieve these targets is to turn part of short-term deposit to medium- and long-term loans. Moreover, the first target is also hard to achieve if the interest rate isn't high enough to encourage both the public and commercial banks pay attention to long-term investment. Currency conversions in the past showed that the public held some 70% of currency circulation and some 20 million of gold taels (equalling US$7 billion). This was really a great source of dead money that the banking system had better find measures to tap.

3.Solutions

As we know, interest is the price paid for the use of capital, so it plays a decisive role in attracting capital, especially medium- and long-term one. The mobilization and supply of the medium- and long-term capital must meet three requirements regarding interest rate:

-The longer the term of the loan, the higher the interest rate, and vice versa.

-The lending rate rises as the deposit rate rises, and vice versa.

-The difference between the lending rate and the deposit rate must be reasonable enough to ensure profit for commercial banks.

In addition, the control over interest rate must aim at targets set forth by the national development programs. In Vietnam, the policy on interest rate must aim at stabilizing the internal value of the currency, controlling inflation and speeding up economic growth. So the above-mentioned requirements must be handled in a way that is appropriate to targets pursued by the interest rate policy.

In this direction, we can suggest two solutions:

a.Making the medium- and long-term deposit rate higher than the short-term one: As was stated above, the deposit rate for 24-month deposits must be 1.20%, or at least 1.15%, to facilitate the mobilization of long-term capital.

b.Rising the lending rate on medium- and long-term loans: If the difference between the lending and deposit rates is 0.30% a month (lower than the maximum difference of 0.35% set by the central), the ceiling of medium- and long-term lending rate must be somewhere between 1.45% and 1.50% a month.

However, the Government is trying to keep the interest rate low with a view to encouraging investment and production, therefore a problem is arising from this policy: the medium- and long-term deposit rate must be high enough to attract long-term capital from the public but it is also low enough to encourage new investment in production and ensure reasonable profit for banks.

To solve this problem is to ensure interests for the public, the banking system and companies. At this point, it seems that the central bank has only paid attention to its interests because the ceiling on interest rate on medium- and long-term loans set by the central bank has never been reasonable enough to encourage both commercial banks and potential depositors.

In fact, the interest rate on short-term loans charged by commercial banks has been higher than the interest rate-ceiling set by the central bank. Many commercial banks have paid a deposit rate of 1.05% a month to 12-month deposits. If the required reserve is included, the interest rate on 12-month deposits has amounted to 1.17% a month. Therefore we can deduce that commercial banks couldn't charge interst at 1.20% a month and they had to charge an interest rate of at least 1.50% on short-term loans while the ceiling fixed by the central bank is still 1.20% a month.

The central bank always declares that the interest rate policy is kept flexible but in fact, adjustments to interest rates have been always made slower than changes in the market. At present, the central bank had better raise the ceiling on interest rate, especially on medium- and long-term interest rate, because the exchange rate of the VNĐ to the dollar is falling and the inflation is showing upward tendency. In order to avoid sudden changes, the central bank can raise the ceiling on short-term loans to 1.35% a month, and 1.50% on medium- and long-term ones, increasing the difference between interest rate on short-term and on medium- and long-term to 0.15% a month with a view to encouraging the supply and demand of medium- and long-term loans.

In the coming years, the central bank had better allow the interest rate to vary to a certain extent from the fixed ceiling on the interest rate with a view to helping commercial banks enjoy more autonomy in working out their business strategies■

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