

FLOATING INTEREST RATE A NEW DEVELOPMENT OF THE MONETARY POLICY

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1. Process of liberalizing the interest rate

a. Before 1995: Both deposit and lending rates were fixed by the SBV. In 1993, the SBV adjusted the inter-

loans in foreign currencies increased from 7.5% a year to 8.5% and 9% respectively.

In 1995, the SBV controlled only the lending rate ceiling and deposit rate floor. In this year, the rate on

The control over interest rate in this period was presented in the following table.

b. Period 1996-1999: The SBV set the lending rate ceiling. On Jan. 1, 1996, a new regulation

Table: Bank rates in 1993-95 (% per month)

	1993		1994		1995	
	April 20	Oct. 1	Aug. 1	Nov. 1	July 1	Sep. 15
I. Deposit rate						
1. Call deposit						
– Personal account				0.3-0.5	0.5-0.7	0.5-0.7
– Savings account	0.8	0.7	0.7	0.7	0.7	0.7
– Corporate account	0.1	0.1	0.1	0.1	0.5	0.7
2. 3-month deposit						
– Personal account			1.4	1.4	1.4	1.4
– Savings account	1.7	1.4	1.4	1.4	1.4	1.4
– Corporate account	1.0	0.8	0.8	0.8	0.8	0.8
3. 6-month deposit						
– Personal account			1.7	1.7	1.7	1.7
– Savings account		1.7	1.7	1.7	1.7	1.7
– Corporate account	1.0	1.0	1.0	1.0	1.0	1.0
4. 12-month deposit		2.0	2.0	2.0	2.0	2.0
II. Lending rate			2.1	2.1	2.1	2.1
1. Short-term loan	2.3	2.1	2.1	2.1	2.1	2.1
2. Long-term loan	1.5	1.2	1.7	1.7	1.7	1.7
3. Overdue loans	a	a	a	a	a	a

(a) 150% of the corresponding rate.

est rates two times, in April and October. The lending rate was reduced from 2.2% in January to 1.6% a month at the year's end (the lending rate on long- and medium-term loans reduced to 1.2% a month) while the inflation rate was 5.3% that year. In this period, the SBV set the interest rate ceiling and stopped discriminating in favor of the public sector in terms of lending rate, thereby helping commercial banks gain full autonomy in attracting deposits.

In 1994, the gap between rates on loans in domestic and foreign currencies was reduced. The lending rate on long- and medium-term loans and

call deposits was raised to 0.7% a month, and lending rate on loans in foreign currencies from 9% to 9.5% a year.

Before 1995, the lending rate on long-term loans was always lower than the rate on short-term loans and on 12-month deposits. The reason was the fact that the long- and medium-term loans and deposits from the public were scarce. Most of them came from the Treasury and foreign loans and they were mainly used for major development programs. No long- and medium-term loans were available for private persons and companies.

about the interest rate was issued after the National Assembly decided to revoke the Bank Profit Tax Law. According to this regulation only set the lending rate ceiling. The lending and deposit rates were decided by the manager of the commercial bank on the condition that the difference between those two rates was 0.35% a month at most.

In 1997, the SBV tried to adjust the lending rate ceiling to the inflation rate in order to encourage the economic growth. After July 1997, the interest rates were lower than those offered in 1996. At the end of 1997, however, the deposit rate be-

came higher because of the Asian financial crisis while the lending rate wasn't allowed to rise, which made the banking business less active.

In January 1998, the SBV raised the rates on loans in the domestic currency slightly and cut the rates on foreign currency loans to cope with the higher inflation rate, and remove the regulation about fixed difference between rates. As for loans in the dollar, the deposit rate was set at 4.5% a year and the lending rate at 8.5% a year.

After Feb. 1, 1999 the ceiling of short-term lending rate offered by commercial banks reduced to 1.1% a month and long- and medium-term lending rate 1.15% a month.

After June 1, 1999, the ceiling rate was 1.15% for all lending terms and all banks while the lending rate for credit societies and public credit fund was 1.5% a month.

After Aug. 1, 1999, the ceiling of lending rate reduced to 1.05% a month while the lending rate in rural areas was 1.15% a month and rate offered by credit societies and public credit fund was 1.5% a month.

On Sep. 4, 1999 the ceiling reduced to 0.95% a month and no changes was made to other rates.

On Oct. 25, 1999 the ceiling fell to 0.85% a month; in rural areas 1% a month and in credit societies and public credit funds 1.5% a month.

Thus, the SBV cut the ceiling rate five times in 1999 in order to stimulate the market demand.

Table 2: Ceiling of the lending rate in 1996-1999 (% per month)

Lending rate ceiling	1996			1997			1998			1999		
	Jan. 1	July 15	Sep. 1	Jan. 1	July 1	Jan. 1	Feb. 1	June 1	Aug. 1	Sep. 4	Oct. 25	
Short-term loan	1.75	1.6	1.5	1.25	1.0	1.2	1.1	1.15	1.05	0.95	0.85	
Long-term loan	1.7	1.65	1.55	1.35	1.1	1.25	1.15	1.15	1.05	0.95	0.85	

c. Period 2000- now: The SBV only fixed the base rate and got prepared for liberalization of interest rate.

From January to the end of July 2000, the SBV kept setting the ceiling of lending rate on both VND and foreign currency loans and maximum interest rate on deposits in foreign currencies.

After Aug. 2, 2000, the SBV decided to control the banking system through the base rate according to the State Bank of Vietnam Law and Decision 241/2000/QD-NHNN dated Aug. 2, 2000.

The lending rate on VND loans shouldn't exceed the base rate plus a narrow band fixed by the SBV Governor. The base rate publicized on a monthly basis was based on commer-

cial lending rates offered by banks to their most favorable customers. To the end of 2000, the base rate was 0.75% a month with a band of 0.3% for short-term loans and 0.5% for long-term ones.

As for loans in the dollar, the lending rate was kept under the SIBOR plus a narrow band set by the SBV Governor. This band in 2000 was 1% a year for short-term loans and 2.5% for long-term ones. Thus the local base rate started to be connected with an international rate and based on the market one. This is a new step forward the liberalization of rate.

In 2001, the SBV cut the base rate on VND loans with a view to expanding the credit volume and local production, and at the same time, started to liberalize rates on loans in foreign currencies.

prevent converging the VND to the dollar and prepare for the liberalization of rates on loans in the VND.

In June 2002, the SBV base rate was only a basis for reference and commercial banks were allowed to decide their lending and deposit rates based on the supply-demand relation. In other words, the rate on loans in the VND was also liberalized, one year after the liberalization of rate on foreign currency loans.

In the first half of 2002, the interest rate was stable; the deposit rate rose slightly. The difference in deposit rate between loans in the VND and the dollar was wider – around 5% a year- and thus preventing conversion of capital in VND into capital in the dollar.

Thus, the process of liberalizing the interest rate was completed within seven years, from 1995 to

Table 3: SBV base rate from August 2000 to June 2002

	2000		2001			2002	
	Aug. 2	March 1	April 1	June 1	Oct. 1	June 1	
Base rate	0.75	0.72	0.7	0.65	0.6	0.625	
Band for short-term loans	0.3	0.3	0.3	0.3	0.3	0.3	not fixed
Band for long-term loans	0.5	0.5	0.5	0.5	0.5	0.5	not fixed

As for loans in the VND, the base rate was cut four times but the band was the same, which encouraged commercial banks to cut their lending rates. These rate stayed around 0.6% - 0.75% a month for short-term loans, and 0.65% - 1.0% a month for

2002. This effort is suitable for the worldwide development trend when the Vietnamese economy became stable.

2. For a more perfect liberalization

long- and medium-term ones.

As for rates on loans in foreign currencies the SBV in the first months of the year still based the rate on the 3-month SIBOR plus 1% per year for short-term loans and the 6-month SIBOR plus 2.5% per year for long- and medium-term ones.

After June 1, 2001, the SBV stopped fixing the band and liberalizing the rate on loans in foreign currencies. As for deposits in foreign currencies by companies and organizations with banks, the SBV still fixed the interest rate with a view to preventing the tendency to keep too large sum of foreign exchange in their account. The deposit requirement was reduced from 50% to 40%.

These measures helped establish a stable and reasonable base rate,

of interest rate

The following are our suggestions about the liberalization process.

The SBV could use other instruments to make the interest rate suitable to the monetary policy and development targets.

- Inflation rate must be kept under level set by the National Assembly.

- It's necessary to establish a relation between the bank rates and the SBV discount rate in order to help the SBV use the latter to regulate the former.

- Commercial banks must take measures to cut costs and diversify their services in order to become more competitive when integrating into the international market. ■