On the Exchange Control in the Past Few Years

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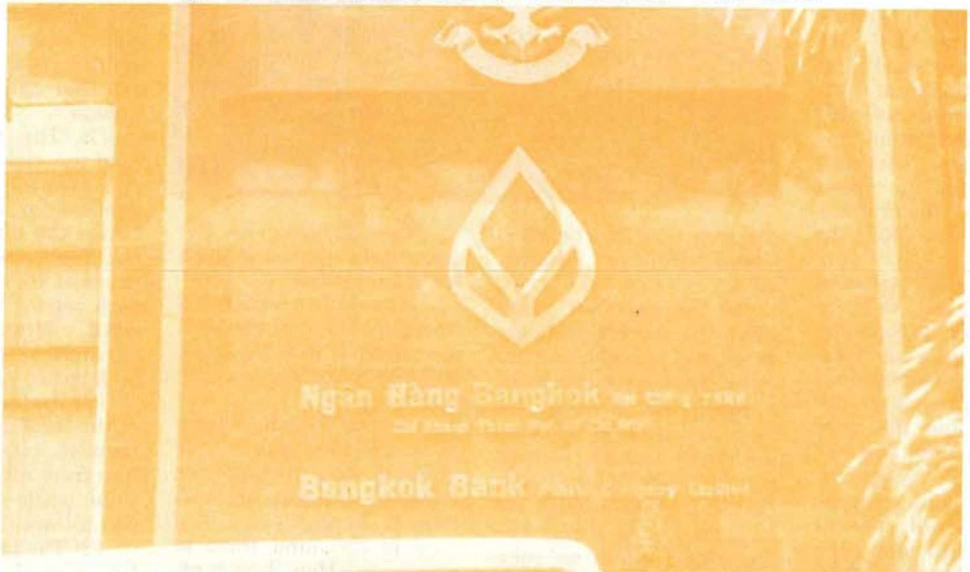
The control over foreign exchange and exchange rate is central to the macroeconomic management of a country of service of development targets, stability of the external value of the currency, promotion of export and reduction in foreign debt. A country could follow either the fixed or floating exchange rate systems.

The floating system is usually found in developed countries with convertible currencies that could traded on all financial markets, such as the U.S., Japan, the EU, Singapore, Australia, etc. Certain Asian countries have recently adopted this system but their central banks take various measures to intervene in the exchange rate if need be. For example, when the yen rises against the dollar, the BOJ sells large amounts of yen with a view to preventing it from rising and causing harm to the Japanese export. On the other hand, the BOJ sells the dollar and withdraw the yen when the dollar rises against the yen.

China is a typical country that adopts the fixed exchange rate system. Its exchange rate has been fixed at reminbi 8.3 to the dollar for years. A few months ago, the U.S. wanted it to float the exchange rate but it seems that China hardly changes their policy because it is also an economy in transition, and like other developing countries, it wants to promote its export, and at the same time, to ensure its independent exchange control policy. The Chinese foreign exchange reserve reaches US$380 billion now.

Before the 1997 financial crisis, most Southeast Asian countries followed the fixed exchange rate policy. This policy along with shortcomings in the banking systems led to the crisis. After that, they decided to adopt the floating exchange rate to a certain extent.



When developing the market economy, the Vietnamese government has adopted a more flexible exchange control. After two Banking Laws came into effect in October 1998, the exchange rate was allowed to change according to conditions of supply and demand in the market while the central banks could affect the rate by employing monetary regulatory instruments. They are:

- Required reserve for deposits in foreign exchange: The required reserve ratio is adjusted regularly according to changes in the interest rates and other conditions on both foreign and domestic markets.
- Regulating and controlling foreign currency deposits in banking institutions.
- Intervening in the inter-bank foreign exchange market and publicizing the official rate everyday.
- Offering the SWAP service to banking institutions.
- Regulating the band on rates applied by banking institutions.
- Applying the liberal mechanism on the interest rate on foreign exchange: The central bank fixes the rate on foreign currency deposit by customers in banking institutions and by these institutions in the central bank.
- Introducing certain regulations relevant to the exchange control, such as allowing the Option service, allowing loans in foreign currency for more class of borrowers, setting operating conditions of foreign exchange offices, setting limits on undeclared foreign exchange brought abroad by individuals, etc.

Generally, the central bank has gradually adopted the use of indirect instruments for regulating the exchange rate, which was more suitable to the market mechanism and international practices, in an effort to integrate into the regional market.

Under such a regulatory mechanism in the past two decades, the domestic currencies depreciated reasonably, which created more favorable conditions for export business than the import one, and caused

Table 1: The VND depreciation

Currency	Jan. 3, 2003	May 19, 2003	Change	Oct. 31, 2003	Change*
Sold by the Vietcombank					
US$	VND15,406	15,472	0.43%	15,647	1.56%
EURO	VND16,238	18,133.7	11.0%	18,274	12.6%
JPY	VND130.55	134.88	3.32%	144.69	10.1%
GBP	VND24,925	25,472	2.2%	26,639	6.87%
Sold on the free market					
US$	VND15,415	15,495	0.52%	15,660	1.60%

difficulties in repayment of foreign debts. The rate of depreciation of the domestic currency was as follows: 14.2% in 1997; 9.6% in 1998; 1.1% in 1999; 3.4% in 2000; 3.8% in 2001 and 2.1% in 2002.

In 2003, changes in the international foreign exchange market were more complex. The main one was the continuous depreciation of the dollar. In the first four months of the year, the dollar fell by 6.75% compared with the euro; 0.23% with the yen; 1.21% with the Singaporean dollar and 1.11% with the Thai baht. And its has kept falling so far. In the past twelve months, the dollar fell by 22% against the euro and 9% against the yen. The situation affected the local market greatly. Up to early November we could see that the exchange rate of the VND to the dollar had been rather stable, or fell slightly, while it fallen remarkably against other hard currencies. The following table shows the depreciation of the đồng up to the end of October 2003.

The changes show that the trade in the local foreign exchange market was stable. The depreciation of the domestic currency against the dollar was some 1.6%. However, the fall was more remarkable in the last two months: 0.27% in September and 0.56% in October. We can estimates based on changes in the last two months that the depreciation of the VND in the whole 2003 will be somewhere between 2.2% and 2.5% - a degree of depreciation that could be seen as normal.

However, the VND fell considerably against the Euro, yen and pound, especially the euro. This is understable and inevitable because the euro has risen strongly against the dollar and other hard currencies. The same tendency was also found in the yen and the pound. That is why they became dearer than the dollar in the local market.

As was stated above, the depreciation of the VND affected favorably the export business. When the VND falls considerably in comparison with hard currencies, exporters could purchase a lot of farm products (coffee, rubber, black pepper, cashew nut, wooden furniture, rice, aquatic products, etc.), thereby helping peasants sell their produce, make some profit and repay debts to banks. Products of light industries, such as clothing, footwear, ceramics, wooden works of art, etc. are also saleable on foreign markets due to their low prices, which in turn increase the income of producers and laborers as well.

The number of Vietnamese laborers working abroad rose fast this year and immigrant remittances are estimated at US$2.5 or 2.6 billion. This source of foreign exchange helps ensure the foreign exchange reserve for the central bank and implementation of the exchange control.

However, the depreciation of the domestic currency also has its own side- effect. Vietnam always faces trade surplus and deficit balance of payments. In the 10 months of 2003, the trade gap amounted to some US$3.7 billion. When the hard currencies become dearer, it requires more time and efforts for Vietnam to reduce the deficit and repay foreign debts.

At present, Vietnam has to give priority to the export of its staples that affect the lives of the working class. An exchange control mechanism that aims at devaluating the domestic currency by degrees could bring about many benefits. In 2003, this mechanism proved its positive effects on the economy although many experts and high-ranking officials haven't totally agrred with it. ■