

# INTEREST RATE, CHEAP MONEY POLICY AND ECONOMIC GROWTH

by NGUYỄN ĐỨC HOÀN

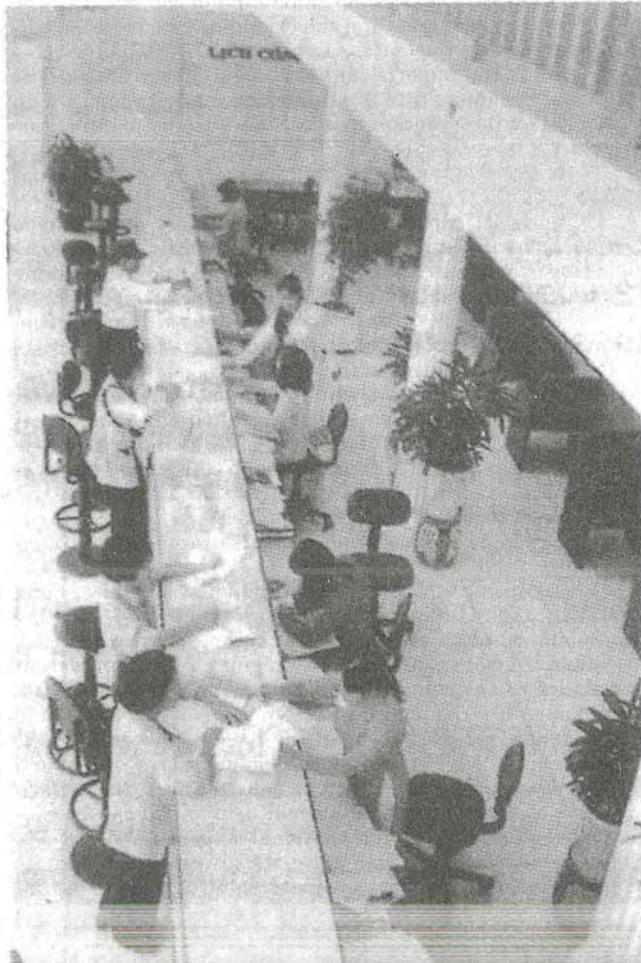
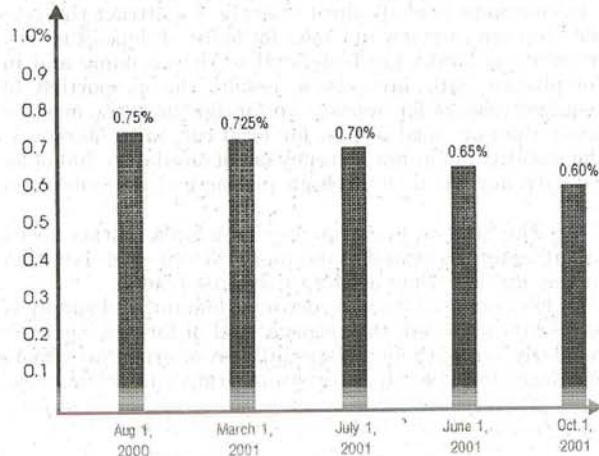
**A**fter terrorist attacks in New York and Washington on September 11, the FED decided to reduce its interest rate from 3.5% to 3.0% as from Sep. 17, 2001. This is the eighth cut this year. After that, the Europe Central Bank (ECB) reduced its interest rate on the euro. The same thing also happened to the LIBOR and SIBOR. In Vietnam, the interest rate on deposits in the dollar reduced to 3.2% or 3.3% a year as compared with 6% offered in the corresponding period last year. Facing such a situation and considering the growth rate in the past few months, the SBV reduced its minimum lending rate from 0.65% a month to 0.60% as of Oct. 1, 2001, and this is its fourth cut this year. But the question is whether there is any further cut in the interest rate or the minimum lending rate and what effects on the economic growth are.

Changes in the interest rate on the world market in the last two years are as follows:

Table 1: Changes in the interest rate on the world market

Date	Changes by FED	SIBOR	LIBOR
Jan. 2, 2000	5.75% a year	6.500%	6.600%
March 21, 2000	6.0%	6.767	6.763
May 16, 2000	6.5%	7.500	7.482
Jan 3, 2001	6.0%	7.185	7.188
Jan 31, 2001	5.5%	5.121	5.125
March 20, 2001	4.50%	4.604	4.601
April 18, 2001	4.25%	4.380	4.384
May 15, 2001	4.0%	4.871	4.864
June 27, 2001	3.75%	4.063	4.060
Aug. 21, 2001	3.50%	3.632	3.628
Sep. 17, 2001	3.0%	2.990	2.988

Figure 1: Changes in SBV base rate



Studying changes in the interest rate, we saw the following facts:

- At present, the Vietnam's foreign exchange market is integrating into the world and regional markets, so all changes in exchange rates of hard currencies produce effects on the Vietnamese financial market.

Before June 2001, the SBV set the lending rate based on the 3-month SIBOR plus a band of under 1% for short-term loans and 6-month SIBOR plus a band of 2.5% at most for medium-term loans. From June 1, 2001 on, the SBV lifted the restriction on the interest rate and allowed banking institutions to decide on their lending rates based on interest rates on the world market, and supply of and demand for foreign exchange in Vietnam. This is considered as a liberation of interest rate on loans in foreign exchange. That is why the banking system is affected strongly by international interest rates. We must realize the fact that, to the end of the year, the demand for the dollar usually rises when importers are to settle deferred payment L/Cs, so the lending rate on loans in the dollar only falls slightly.

- In the past few months, the shortage of the domestic currency forces commercial banks to raise the deposit rate to attract more idle money. The situation is improve now and the supply-demand relation is in equilibrium again and commercial banks tend to consider reducing the deposit rates. When the SBV base rate is cut, the lending rate is hard to stay the same.

- There is a continuous exchange of the domestic currency for foreign ones and vice versa when changes in interest rates on loans in the domestic and foreign currencies aren't in the same direction and when there are changes in the exchange rate. In the past few months, difference in interest rates on loans in the domestic and foreign currencies was very small while the exchange rate between the domestic currency and the dollar changed continuously, the dollar rose against the domestic currency, therefore companies preferred loans in domestic currency to those in foreign ones and they use the loans to buy foreign exchange. The public tended to withdraw money from banks to buy the dollar. This tendency was the main reason for the shortage of domestic currency and the surplus of foreign exchange in commercial banks. After the interest rate on deposits in the domestic currency rose while the rate on deposits in the dollar fell, the exchange of domestic currency for the dollar ceased. If the interest rate on deposits in the domestic currency falls while the dollar rises strongly against the domestic currency, the said tendency will come back and commercial banks will face the shortage of the domestic currency again.

However, there are other reverse tendencies:

+ At the end of every year, the demand for bank loans always rises.

+ At the end of the year when the public spend a lot of money on celebrations and household goods, trading companies increase their inventory investment, and markets for real estate; motorbikes and electronic equipment become busier, the bank deposits always decrease.

Unlike the interest rate on loans in foreign exchange, the SBV base rate is established by considering the rate offered to the most creditworthy customer by large commercial banks, including joint venture and foreign banks. These banks tend to offer their base rates to the best customers. Large state-owned corporations and companies with good performance usually enjoy very low interest rates offered by banks, from 0.58% to 0.62% a month. This rate is the *flô* one, lower than the SBV base rate and equal to rates offered on the world market. Facing the shortage of the domestic currency, many banks raised the deposit

rate to somewhere between 0.58% and 0.65% a month. At the end of September, some branches of the Bank for Agriculture and Rural Development even offered a deposit rate of 0.70 – 0.72% a month to 24-month deposits, a deposit rate that was higher than its lending one. That is why all commercial banks find it difficult to reduce the lending rate any more, even for the best customers. If they keep reducing the lending rate, they must cut the deposit rate accordingly, then the tendency to exchange the domestic currency for foreign exchange will take place again.

As was stated above, rates offered by commercial banks are used by the SBV for reference only when publicizing its base rate and it's national and international economic development that serves as a basis for establishing the base rate. In the domestic market, the planned growth rate seem hard to achieve, both production and consumption of many goods are in the doldrums while the foremost objective of the monetary policy carried out by the SBV is to stimulate the economic growth. The present situation forces the SBV to consider adjusting its base rate. Many experts think that even if there are more cuts in the lending rate, export of certain goods, such as coffee, rubber, rice, cashew nut and garments still meets with great difficulties. Therefore, it is unlikely that the SBV will take a further cut in its base rate, and if any, the cut won't affect significantly the reduction in the lending rates by commercial banks.

Facing such a situation, many banking experts suggested adopting the cheap money policy by taking the following measures:

- Adjusting the refunding rate, discount rate and using other instruments to stimulate cuts in the lending rates by commercial banks by lowering the required reserve ratio for deposits in foreign exchange from 15% to 5% or 6%, taking a 1% or 2% cut in the required reserve ratio for deposits in the domestic currency, reducing deposit insurance fee from 0.15% to 0.10% or 0.11% with a view to encouraging commercial banks to cut their lending rates.

- Adopting a more flexible mechanism for increasing the money supply through refunding and open market operations, and lowering the exchange rate used for currency swap operations.

- Urging commercial banks to reform lending procedures, perfect internal financial mechanism and management, encourage lending officials to seek for investment projects and new customers and reduce workload of lending officials.

- Refraining from applying the Criminal Law to the relationship between customers and banks, releasing assets mortgaged to banks after court's decision on debt settlement, and dealing with obstacles to lending operations (in supplying bank loans to farms, loans of over VND10 million on mortgage, or supplying loans to firms in EPZs or IPs, etc.)

When the economy is in the doldrums, the monetary policy is always the first thing to be reviewed. Experience from foreign countries, especially from the U.S., Japan and Southeast Asian countries, shows that a cheap money policy is necessary in such a situation. Carrying out this policy requires efforts from the Government, the central bank and all commercial banks and the use of various monetary instruments instead of cuts in the interest rate only ■