people will lose their trust in VNĐ, the stability of our monetary and economic system will disappear... We have to do our best to avoid such a crisis, our achievements in recent years will be lost.

Therefore, I'm inclined to support the second viewpoint: to maintain the adjustment to the exchange rate. Due to the policy on adjustment to the exchange rate, the inflation rate was kept low, our monetary system became stable, the domestic investment increased and helped accelerate the economic growth rate (7.5% per year on average). However, in order to make this policy more effective, the Central State Bank should pay attention to the followings:

- To stabilize the monetary system doesn't mean to keep the exchange rate at a standstill, but to adjust it to the inflation rate of VNĐ and other currency as well.

For example, the price of US$ in early 1994 was 10,840 VNĐ, the inflation rate of US$ was 2.8% per year, and that of VNĐ was 9% per year, then the exchange rate between these two currencies in late 1994 (according to the theory of purchasing power parity put forward by Ricardo and Cassel) can be calculated as:

$$\text{Exchange rate (A/B) at Tc} = \text{Exchange rate (A/B) at To} \times \left(\frac{1 + \%\,IB}{1 + \%\,IA}\right)$$

Where A: US$
B: VNĐ
IA: Inflation rate of US$
IB: Inflation rate of VNĐ
Tc: Closing time
To: Opening time

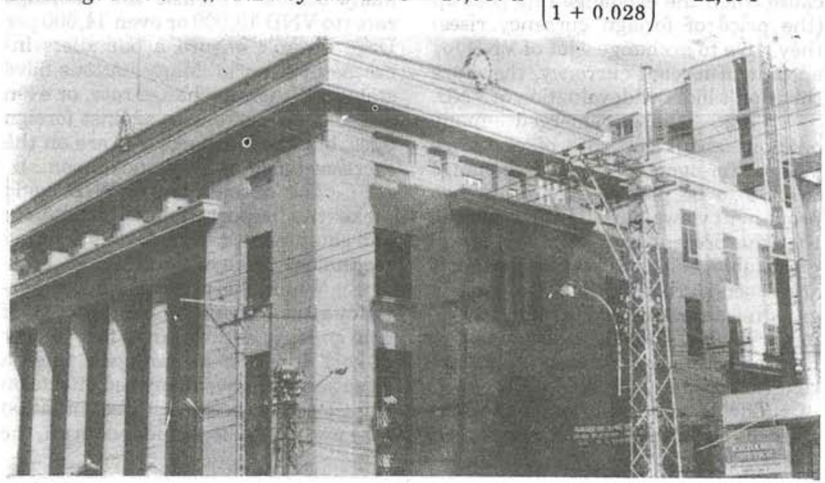
$$\text{Exchange rate (US\$/VNĐ) by late 1994} = 10{,}840 \times \left(\frac{1 + 0.09}{1 + 0.028}\right) = 11{,}494$$

Thus, if we don't take other factors into consideration but inflation rate, the reasonable exchange rate between two currencies by late 1994 will be VNĐ 11,494 to US$.

- To pay attention to our balance of payments: From now on, the inflow of foreign currency will increase because we will receive a lot of foreign aid, loans from international financial institutions (IMF, WB, ADB...) and foreign governments, foreign investment, along with the source of foreign currency from Vietnam expatriates and tourists. Therefore our balance of payments will be favorable and the supply of foreign currency will increase. Thus, the exchange rate may fall below 11,494 per US$.

- Other factors, such as marco-economic index, monetary-financial policies, the difference between interest rates paid by foreign currencies and that paid by VNĐ... should be also taken into account.

Considering all above-mentioned factors, we could forecast that the exchange rate will be around VNĐ 11,200 to US$. But, the exchang rate should be continuously adjusted to the fluctuation of exchange rate in international markets, because the international exchange rate is every sensible of political, socio-economic events, of wars, acts of God, economic index, and even psychological problems ♣



Recently, many economic magazines carried articles discussing the exchange rate in Vietnam economy. Although each articles mentioned an aspect of the problem or two, but in general, there were two opinions.

The first argued that the present exchange rate of VNĐ was too high in comparison with its real value, and so it's hard to promote exports and attract foreign investment. These authors petitioned the government to devaluate the VNĐ in order to encourage exports, limit imports and attract foreign investors.

The second opinion thought that the present price of the VNĐ in recent years was appropriate, stable and reasonable and if need be, it could be adjusted gradually, thereby avoiding economic, monetary and social unrest, especially psychological shock to the people and businesspersons as we have seen before the 1990s.

Thus, is the price of VNĐ low or high, reasonable or unreasonable, and if it needs adjustment, so how will we adjust it? To answer these questions isn't a simple matter, because it's difficult to quantify all of the factors affecting the exchange rate, or forecast their changes. These factors are the balance of payment in a given period, the annual inflation rate, structure of imports-exports, the difference between interest rates paid by foreign currency and by VNĐ, the policies on monetary system and trading activities, to name but a few.

We can easily agree that the exchange rate is one of the main regulator for foreign currency supply and demand, therefore it has strong effect on the production, trading, foreign trade of a nation. A low exchange rate can encourage imports (it makes imports cheaper for home buyers) and put exports at a disadvantage (it makes exports dearer for foreign buyers), therefore it discourages the capital inflow and makes foreign exchange reserve smaller. On the contrary, a high exchange rate (the price of the VNĐ is low as compared with foreign currency) will make imports dearer and exports cheaper, thus it will encourage exports.

There are usually two kinds of the exchange rate: basic exchange rate referring the relationship between home price floor and international price floor. It reflects the relationship between the price of exports and the price floor in export turnover, not in GDP of a country. The second is practical exchange rate used in foreign exchange trading in the market: this rate

LOW OR HIGH ?

THE PROBLEM OF EXCHANGE RATE BETWEEN VNĐ AND FOREIGN CURRENCIES

by Dr. ĐÀO DUY HUÂN

is very sensible of changes in supply and demand relation in money market.

The problem is how to calculate exactly those two echange rates. There are many ways of calculating but we agree with REER formula of IMF, especially when, in our country, the international settlement is mostly (90%) done in US dollar, this formula could be expressed simply as:

$$REER : WEERdv \times \frac{Pvn}{Pi} = \frac{Pvn}{(WEER\ vd)\ (Pi)}$$

Where WEERdv: nominal exchange rate VNĐ to US$

WEERvd: nominal exchange rate US$ to VNĐ

Pvn: Vietnam price index

Pi: Price index in Vietnam's trading partner countries calculated by percentage as P1W1 x P2W2 x ...PnWn.

Basing on numerical date about Consumer Price Index and export turnover of Vietnam and our trading partners such as Japan, Singapore, Taiwan, South Korea, Hong Kong, France... we could find out REER index:

Starting from 1992 as the selected base year (index value: 100), the REER index in 1993 is 99.26 for exports and 99.36 for foreign trade (exports and imports), that means REER index decreased by 0.74% compared with 1992. If 1991 is selected as base year and in 1992 the REER index for exports were 127, it has increased by 27% and in 1993 it's 126.1 (increased by 26% compared with 1991 and decreased 0.74% compared with 1992). When REER index rises, the present price of the VNĐ is higher that its real value, and vice versa.

However, it's neccesary to see that the result of said calculation depends on what index we choose: consumer price index, export price or disinflation index... This calculation showed that the price of the VNĐ goes high because in recent years, the government has carried out the policy of strict control over credit in order to improve the balance of payments, the capital inflow has increased and because of restrictions on foreign trade, therefore the supply of foreign currency has excessed the demand and the low exchange rate had no considerable effects on attracting foreign investment. The abundant supply of foreign currency made the exchange rate lower in late 1993 and early 1994 and put our exports at a disadvantage. But from June 1994 on, the exchange rate began to fall, so the situation was improved but our exports was still at a disadvantage.

The problem is if we devaluate the VNĐ, can the exports be promoted (its planned target in 1994 is 3.8 billion) while our goods for exports are mainly crude oil and agricultural products? The reality showed that with the present exchange rate, the prices of agricultural materials, fertilizer or fuel are too dear for the purchasing power of the peasants. If we devaluate the VNĐ, the prices of these goods will be dearer and such a situation will have bad effects on the economy.

Therefore in the near future, imports couldn't be limited by devaluation. This contradicts to the strategy for economic development from now till 2000. Otherwise, taking a long view, we have to develop export-oriented industries. Experience of Northeast and Southeast Asian countries showed that we should maintain a fixed, but adjustable, exchange rate, control inflation and build a reasonable tax system in order to encourage exports (both manufactured and agricultural goods) and ensure importation of capital goods neccesary for modernizing our economy.

From said analyses, I agreed with other authors about the need of maintaining the present exchange rate. If we want to promote exports and attract foreign investment, we could adjust it step by step, from now until early 1995, it can be devaluated by 3-5%. And at the same time, we have to stop the tendency of using US$ in home trading and settlement.

In order to have an appropriate exchange rate, we should form interbank foreign exchange market in Vietnam banking system (but foreign banks could be allowed to take part), diversify foreign currencies in reserve and in international settlement in order to fix the exchange rate basing on a basket of foreign currencies instead of basing on US dollar only, so that we can calculate our exchange rate with REER and TWI indexes ♣