



ADJUSTMENTS TO LENDING RATE - AN SBV FLEXIBLE APPROACH

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From Jan. 2, 1998 to June 1, 1999, the bank interest rates were fixed by Decision 39/1998/QĐ-NHNN issued on Jan. 17, 1998 by the SBV Governor. Generally, regulations on bank rates by this Decision were suitable to conditions of the market economy in Vietnam at the time and produced many good results, such as:

- + Subsidies in form of soft loans were removed.

- + Discrimination against rural areas in supplying credit was stopped; and thus creating conditions more favorable for agricultural production and socio-economic development in rural areas.

- + All sectors, both public and non-public ones, were allowed to enjoy equal treatment from the state bank.

- + Interest rate was al-

lowed to move according to conditions of market forces and was used as a tool for implementing the monetary policy in each period.

- + Bank loans for prioritized projects, private persons and organizations were ensured.

- + The Decision also helped restrict speculations in foreign exchange and practice of changing deposits in VND to those in foreign exchange, especially in the dollar.

In 1999, however, the economy showed signs of disturbances, such as:

- The growth rate slowed down.

- Deflation made its appearance while the inflation rate didn't increase as expected.

- There was a glut of capital in banks in spite of cuts in the lending rate and rises in the deposit

rate.

- The exchange rate has remained unchanged since October 1998, that is, the value of domestic currency is still too high.

Facing such a situation, to realize the Article 18 of the State Bank Law that stated: "The State Bank of Vietnam fixes and publicizes the base rate and refunding rate", the SBV Governor issued Decision 189/1999/QĐ-NHNN1

to lower the lending rate on loan supplied by banks to the public and Decision 190/1999/QĐ-NHNN1 to lower the interest rate on capital refinanced banking institutions by the SBV. Both Decisions were effective from June 1, 1999.

Decision 189 reduced the rate on short-term loans in VND supplied by both city and rural banking institutions from 1.2%

to 1.15% a month and the rate on medium- and long-term loans from 1.25% to 1.15% a month. Other regulations weren't different from those set by the SBV Decision 39/1998.

Decision 190 reduced both the rate of 1% on SBV refunding loans to banks and the 0.9% rate on loans for rice purchase to 0.85% a month.

Generally, adjustments made in the period from 1995 to 1998 had the same basic contents, such as:

- Reducing the ceiling rate (on both loans supplied to the public and loans supplied by the SBV to commercial banks) with a view to encouraging borrowers to turn bank loans into productive investments.

- Distinguishing between the ceiling rate on short-term loans and that



on medium- and long-term ones.

Adjustments made by Decisions 189 and 190 differ from the previous ones in the following points:

- + Applying one ceiling rate to both short-term and medium- and long-term loans.

- + Reducing differences in interest rates on loans supplied in city and rural areas with a view to encouraging investments in agriculture and rural areas.

- + Removing the discrimination against banking institutions in non-public sectors (such as joint stock, joint venture and foreign-owned banks).

The application of the only ceiling rate to all kinds of credit and banking institutions is a landmark in the task of implementing the interest rate policy of the SBV. Contents of Decisions 189 and 190 express a reform in the task of controlling and regulating the interest rate, and give banking institutions full autonomy in attracting deposits and supplying loans. Banking institutions from now on can base their lending rate for advances and borrowing rate for deposits on the ceiling rate after taking other following factors into consideration:

- Expense of supplying a loan.

- Proportion of bank deposit to loan.

- Repayment risk in each loan.

- Need for production development and new jobs in localities.

- Requirements set by the monetary policy.

The introduction of the only ceiling lending rate could be considered as an effort to remove subsidies in form of soft loans, a legacy from the centrally-planned economy that has existed for a very long time; force banking institutions in all sectors to improve their business performance; bear full responsibility for their decision and pay fuller attention to credit arrangements.

Moreover, the reduction in lending rate according to Decision 189 can help facilitate the issue of government bonds and encourage economic concerns to make the best use of bank loans to maintain their businesses and thereby improving the growth rate in the second half of 1999. This is also considered as a measure to stimulate spending and investment, implement the cheap money policy to make sources of finance

available for all economic concerns and private persons, and limit the deflation that is showing signs of increase.

Decision 189, however, also leads to certain inevitable limitations. They are as follows:

- + The application of the only ceiling lending rate to both city and rural areas won't certainly lead to increase in investment in rural areas because the profitability is low there. To deal with this problem, the SBV, in carrying out the monetary policy in the near future, should take other measures to facilitate the banking business in rural areas, and use foreign aid and interest-free sources of finance to supply low-interest loans to agriculture and rural areas with the aim of helping all farmers rising from below the poverty line by 2001 and bridging the gap between cities and rural areas.

- + The reduction in lending rate will certainly force the deposit rate to be reduced accordingly and this situation will make banks meet with difficulties in competing against non-banking institutions (such as the national treasury and post offices) for deposits.

- + The reduction in the lending rate will put at a disadvantage all banks with small starting capital, especially ones operating in rural areas where most borrowers are farmers. Because farmers usually make small borrowings, so high expense on each loan will cause bad effects on the bank's profit. However, the Decision 189 could be seen as a positive measure because it forces small banks in rural areas to try their best to reduce overheads and improve their business performance.

But realities show that the volume of credit supplied by banks hasn't increased since the second half of 1998 in spite of reduction in the lending rate because the economic growth has shown a downward tendency and many local industries have been running down when facing keen foreign competition and the decreasing spending power. To solve this problem and make the monetary policy work, the Government should take other supporting measures to stimulate the demand for bank loans and the consumption of locally-made goods, thereby maintaining a high growth rate.