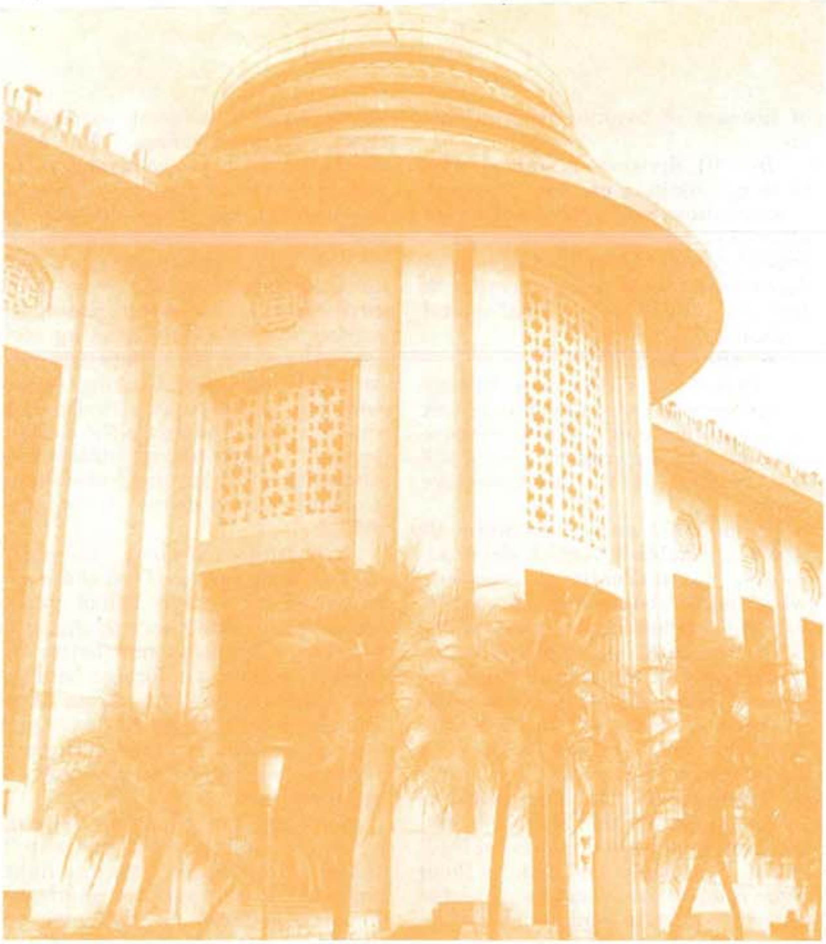

the Japanese production.

In Vietnam on Nov. 9, 2002, the Bank for Foreign Commerce (VCB) cut the interest rate in the dollar from 2.4% to 2.2 a year, a cut that equals only 40% of the FED cut because of VCB customer strategy. Before that day, VCB had to withdraw part of its deposit in foreign bank to finance some national projects. Other banks, such as Bank for Industry and Commerce (ICB), Bank for Investment and Development, Bank for Agriculture and Rural Development, ACB made no reaction up to Nov. 15, 2002 because they had kept the interest rate very low before. After Nov. 18, 2002, most banks cut the interest rate in the dollar to a certain extent. The rate on one-year deposit in the dollar reduced from 2.2% to 2.0% in ICB, and to 1.8% in ACB, the biggest joint stock commercial bank in Vietnam. Rates offered by other banks varied between 2.2% and 2.0%.

What was the reaction of the SBV?

As we know, the interest rate in foreign exchange in Vietnam was liberated in June 2001 to help the foreign exchange market integrate into the world market. Is that why the SBV couldn't intervene? Before June 2001, commercial banks were forced

MONETARY POLICY AND REGULATORY ROLE OF THE CENTRAL BANK

by Dr. NGUYỄN ĐẮC HƯNG

The monetary policy of all central banks in the world aims at accelerating economic growth, controlling inflation rate and moreover, promoting full employment by injecting or withdrawing money, thereby regulating interest and exchange rates and supply of and demand for bank credits. The main targets of the monetary policy are economic growth and inflation control, but this dual target is not always achieved. In many cases, this one is achieved at the expense of the other. When the cheap money policy is adopted, this means that priority is given to the economic growth and prevention of deflation, and inflation is accepted to a certain extent. On the other hand, the tight money policy is used for reducing the inflation rate and preventing the economy from becoming too hot.

Since early 2001, the FED has 12 times cut the interest rate with the only aim of saving the American economy from inflation. FED's decision to reduce the interest rate from 1.75% to 1.25% on Nov. 6, 2002 was beyond what experienced analysts thought possible, because all of them believed that the cut was 25 points at most. So the decision is considered as a bold move which shows that the FED aims more at economic growth than at prevention of inflation with a view to putting an end to the economic recession.

As a rule, any move by the FED affects the interest rates on main money markets in the world, such as LIBOR and SIBOR. The FED cut in the interest rate on Nov. 6, 2002 made the LIBOR and SIBOR reduce to 1.385% a year and 1.400% respectively. The ECB and BOA show no reaction although the euro area and the U.K. enjoy no boom while the BOJ has maintained a 0% interest rate for several years to encourage

to sell only 40% of foreign exchange they held to the central bank. The required reserve ratio for foreign exchange deposit reduced from 15% to 8% and then 5% at present. Limit on the foreign exchange situation reduced from 30% to 15%. However, it is reasonable for the SBV to react more strongly by reducing the required reserve ratio by 2% or 4% in order to prevent the interest rate in the dollar from falling too much, capital from changing into domestic currency, and interest rate in the Vietnamese đồng from falling accordingly. It's necessary to say that difference between interest rates in the domestic and foreign currencies is wide, therefore in the first 10 months of 2002, foreign exchange deposit with VCB rose by only 2% while deposit in the domestic currency rose by 67%.

Fall in the deposit rate in foreign exchange made the lending rate fall accordingly. This is favorable for many major projects that require investment in foreign exchange (power-fertilizer plant in Cà Mau, Phú Mỹ steel mill, cement in Quảng Ninh, Sesan hydropower plant, Tam Điệp and Bút Sơn cenment factories, Dung Quất oil refinery, etc.), other intensive investment projects also enjoy low interest rate when the favored lending rate on the world market is 4.25% a year. These projects will create new jobs, produce exports and help with the economic growth. It's worth noting that in the first 10 months of 2002 the lending in foreign exchange supplied by VCB has doubled in comparison with January.

As for the implementation of the monetary policy by the SBV, it aims at accelerating the economic growth and controlling the inflation rate as required by the National Assembly because Vietnam is in the transition to the market economy. The implementation of the policy couldn't depend totally on signs from the market, it also depend on opinion of the public that didn't share the same concept of the market economy and promise to the IMF whose requirements aren't always suitable to objectives adopted by the Government.

The inflation rate in recent years was low and stable while the growth rate wasn't as high as expected and the unemployment rate was high. The price index was 0.1% in 1999; -0.6% in 2000; 0.8% in 2001 and under 4% in 2002. Many people are of the opinion that the SBV had better increase the money supply because of the danger of deflation. This opinion has its own grounds. From early 2002, the monetary demand increased (going abroad to make studies, get medical care or work; buying houses, expanding business, etc.), therefore the bank rates rose steadily, which force the SBV to regulate the interest rate effectively and flexibly. The rate on one-year deposits in the Vietnamese đồng rose to somewhere between 0.70% and 0.72% - the highest level over past three years – with a view to mobilizing more dead money to the banking system. The lending rate was also raised in order to regulate the demand for borrowings but the demand kept increasing. This situation forced the SBV to decide what target to aim at and what objective to give up. We can say that priority must be given to the economic growth when the inflation is still under control. However, if the inflation rate is higher than expected but the growth rate is higher and the unemployment rate is lower, then everything is all right. The interest rate in the domestic currency has been floated since June 2002 and the base rate is only for reference, therefore the SBV can only intervene indirectly in the interest rate through open market operations, discount rate and changes in the required reserve ratio.

Analyses of changes in the money market and operation of the banking system in 2002 show that, from January to July 2002, the bank credit supplied increased faster than the average in previous years and tended to exceed the target planned for the year and beyond promises to international financial institutions. The total bank credit supplied by the banking system up to August 2002 rose by 16.8% in comparison with late 2001 while the target planned for the year is 21% and the bank credit always increase in the last quarter of the year. In HCMC, the bank credit increased by 14.2% in the first half of the year and tended to exceed 30% by the year's end. That is why regulatory measures were taken while the bank deposit increased slowly and the monetary demand became greater and greater, the market for the domestic currency became hotter and the interest rate tended to rise higher.

Reducing the base rate, increasing the money supply and manipulating effectively regulatory instruments are main features of the cheap money policy that is usually adopted by many central banks to achieve higher growth rate. It's the trend most suitable to economic law Vietnam should adopt. The SBV had better cut the required reserve ratio for deposit in the domestic currency, from 2% or 3% maintained in the past two years to 0% if need be. This measure can release from VND3,000 to 4,000 billion to meet the monetary demand and affect positively the interest rate in the domestic currency because the reserve requirement is a far-reaching instrument.

In principle, the supply of money is determined by the growth rate and inflation rate. Vietnam, however, receives every year some US$2 billion worth of immigrant remittance and 1.4 billion worth of salary for guest workers. This volume of foreign exchange needs a corresponding volume of negotiable instrument. We wonder whether this factor is included in calculation of the growth rate and taken into consideration by the SBV when making decision on the money supply. Moreover, the price index in Vietnam isn't a scientific instrument for measuring the inflation rate, therefore the decision on the money supply must depend on signs from the market instead of the inflation rate and price index.

The inflation rate has been low for years, the SBV can adopt the cheap money policy to help the economy gain high growth rates as it did many years before ■

Photo by Nguyễn Ngọc Đạo