# PRESSING PROBLEMS ARISING FROM THE REALIZATION OF MONETARY POLICY

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Monetary policies of countries aim at different objectives. In Vietnam, the monetary policy aims at accelerating the economic growth and controlling inflation.

At the end of the 1990s, inflation rate in Vietnam stayed high whereas the economy made slow progress. But since the beginning of the 1990s, due to successful realization of the monetary policy and renovation of banking service, the inflation rate has been well under control and reduced from 14.3% in 1994 to 12.7% in 1995 and 3.3% in the first half of 1996, whereas the economy developed fast and stably: 8.8% in 1994 and 9.5% in 1995.

Vietnam's success in changing to the market economy was appreciated by international opinions. However, the realization of monetary policy is posing problems: banks are holding a lot of dead capital while the economy and businesses are badly in need of capital; instruments of the monetary policy didn't give full autonomy to businesses or improve their competitiveness. In short, these instruments are not suited to the market mechanism as shown in the following analyses.

**1. Interest rate**

In foreign countries, inter-bank offered rate often has decisive effects on other rates, and the central banks need only publicize the rediscount rate. In Vietnam, however, the central bank has fixed financial rates of interest. Until recently, the situation has been improved when the central bank fixed only the minimum borrowing rate and the maximum lending rate. This regulation on interest rate was carried out in the period between Oct.1, 1993 and Dec.31, 1995 in which the maximum interest rate on short-term loans in domestic currency was fixed at 2.1% a month, and interest paid to call-deposit accounts changed from 0.1%, to 0.5% and then, 0.7% a month.

On Jan.1,1996, the Governor of the State Bank decided to adjust the lending and borrowing rates: the interest rate of short-term loans in domestic currency was 1.75% at most, and the minimum borrowing rate stayed at 0.7% for domestic currency deposits. The State Bank also regulated that the average difference between lending rate and borrowing rate was 0.3% at the maximum.

After that, on July 16,1996, the Governor decided on reducing the maximum lending rate on short-term loans to 1.6% a month, the lending rate on medium-and long-term loans to 1.65% a month, the rates applied in rural credit funds was 1.8%, and the lending rate charged by People's credit funds was 2.2% a month. The difference between lending and borrowing rates was kept at 0.35% a month. All commercial banks' management thought that this difference was too low for them to cover running costs, and none of them carried out this regulation.

This situation showed that once the State Bank adopted a new viewpoint on the interest rate and gave full autonomy to commercial banks, it could reduce the interest rate, although the lending rate in Vietnam was still too high (from 19% to 20% a year in spite of low inflation rate) in comparison with other countries.

Farmers, and agricultural production, have been forced to pay high interest on their debts although their business gained the lowest profit and involved the highest degree of risk.

To solve this problem, the State Bank had better remove the regulation on the difference of 0.35% a month between rates because it intervened too much in operation of commercial banks, discouraged competition and went against international practices.

The regulation on the borrowing rate of 0.7% could be also removed because it has lost its meaning, and in fact, lost its effect. The State Bank had better fix the maximum lending rate only. By the end of this year, or at the beginning of next year, the State Bank need only fix the discount rate and let the inter-bank rate affect other rates because the inter-bank market has come into being and produced good results for three years. There have been 4 state-run commercial banks, 50 joint stock commercial banks, 2 joint stock finance companies, 4 joint venture banks, 22 branches of foreign banks, 5 insurance companies... in Vietnam. Demand for, and supply of, capital in Vietnam have changed and Vietnam is open to the international capital market, etc. so we had better let the inter-bank rate take its shape based on the relationship between supply of and demand for capital and encourage commercial banks to compete with one another and renovate themselves. This is also the best way to reduce the market lending rate, enhance companies' ability to attract dead money and encourage the formation of Vietnam's capital market. Moreover, this measure could reduce difference between lending rates in cities and rural areas.

**2. Exchange rate and foreign exchange control**

In the end of the 1980s and at the beginning of the 1990s, Vietnam's inflation rate rose and the VNĐ depreciated quickly, at one time, the exchange rate decreased to VNĐ14,500 or 14,600 to the US dollar. The black market trading in foreign exchange developed along with speculation in foreign exchange. After many measures taken by the State Bank, the VNĐ started to rise against the US dollar and the exchange rate has stayed at VNĐ11,000 to the US dollar for two years. The fluctuation in the exchange rate in 1995 was +0.4% and -0.2% in the first half of 1996. In the last two years, the stabilization of exchange rate has caused a lot of controversy. Many economists and exporters argued that the VNĐ's appreciation had caused problems for exporters and contrarily, encouraged importation. They suggested depreciating the VNĐ in order to encourage exportation. However, by stabilizing the domestic currency, the State Bank has initially prevented foreign currencies from going down (because of the increase in capital inflow), and encouraged both exportation and importation to develop. However, the control over foreign exchange and exchange rate is causing many problems:

- The task of controlling trading and paying in foreign currency wasn't done properly: private jewelry shops, especially in Hà Nội and HCMC, traded foreign currency in large quantity without licence. Many hotels, restaurants and shops also did the same.
- In the inter-bank market, supply of foreign exchange sometimes exceeded demand although the State Bank had purchased too much foreign exchange and run short of VNĐ reserves. This made the inter-bank foreign currency market lose its meaning.
- Commercial banks didn't carry out properly regulations on foreign exchange control. Branches of foreign banks and joint venture banks complained that they suffered losses because they observed these regulations.
- The capital inflow increased because the borrowing rate paid to deposits in domestic currency was high (from 10% to 12% a year) in comparison with rates in regional countries. Moreover, the inflation rate was low and the exchange rate stable, so a lot of foreigners and Vietnamese expatriates transferred foreign currency to Vietnam, changed it into VNĐ and deposited it in banks for interest.

Other causes of the increase in capital inflow are: Vietnam companies opened L/C to import consumer goods (some US$500 million by HCMC-based companies alone in the first half of 1996), or borrowed money from foreign sources (some US$1.5 billion up to June 1996); the Vietnam Government received aid, loans, ODA investment, payments for exports, etc.

Facing this increase, the State Bank found no effective ways to control, or attract these sources of foreign currency to the banking system. This situation could make foreign debt a burden, cause the VNĐ to rise against the US dollar and make the effort to turn the VNĐ into the only legal tender in Vietnam end in failure.

- Because the lending rate on loans in domestic currency is from 1.6 to 1.8 times higher than the rate charged on loans in foreign currency, so all Vietnam businesses tried to borrow loans in foreign currency, sold it or used it to import consumer goods, sold them for VNĐ and deposited for interest. This made it difficult for the central bank to control flows of foreign currency.
- Foreign invested companies and joint ventures with foreign partners which sold their products for VNĐ met with difficulties in getting foreign currency needed for importing materials because the Decision 396/TTg of the PM had come into effect.

Solutions to this problem are: to amend the Decision 396/TTg and the Circular directing the realization of the Decision 396/TTg; to control foreign debts and borrowings in foreign currency from banks more strictly; to develop the operation of inter-bank foreign currency market and let inter-bank offered rate regulate other rates. Moreover, the State Bank had better intervene in the exchange rate to a limited extent allowed by the monetary policy and allow the exchange rate to be adjusted by the invisible hand of the market.

**3. Reserve requirement**

Reserve requirements have been set forth by the central bank since the beginning of the 1990s when the two-level banking system and two Ordinances on Banking came into effect. In last few years reserve requirements have helped to limit the multiple expansion of bank deposits and the volume of credit made by commercial banks, and control inflation rate. Recently, regulations on reserve requirements have been amended (increase in times calculating reserve requirement every month, putting reserve requirements in a demand deposit, etc.) and have enabled the central bank to regulate cash reserves of commercial banks more easily, thereby controlling the interest rate and volume of credit, and helping commercial banks employ more effectively bank deposits.

However, reserve requirements are also causing problems:

- Some state-run commercial banks and most joint stock commercial banks didn't observe reserve requirements and the central bank wasn't determined to prevent these violations.

- At present, most commercial banks are holding a lot of dead capital and finding no borrower, so keeping reserves loses meanings to them, especially when they observe credit control regulations.

- The percentage of reserve for deposits in foreign currency is too high and limits the multiple expansion of deposits.

The solution to this problem is that the State Bank takes measures to force all banks to meet reserve requirement and to apply sanctions against violations if need be.

**4. Credit control**

This tool was introduced in 1995 in order to control the volume of credit, control inflation and ensure the quality of credit supplied, but many commercial banks haven't observed the limit set to their volume of credit.

However, many businesses and commercial banks complained that the State Bank needn't set limit to the volume of credit because there has been reserve requirements. Many others said that the credit control was only an administrative measure.

The following are problems caused by this tool:

- This tool aims at controlling inflation, but where was this tool when the inflation was high? And in the first half of this year when the inflation was low, why didn't the State Bank remove this regulation?

- Some high-ranking officials of the State Bank said that many commercial banks couldn't supply credit to its limits. Thus, what is the effect of this tool?

- Limits set by the State Bank weren't appropriate to situation of each bank, so some banks couldn't supply credit to its limit, while some others have supplied over the limits.

- The credit control couldn't ensure the quality of credit supply, because until recently the increase in bad debts has been caused by: violations of regulations on credit supply, defects in laws system, dishonest customers and bank employees, business risk, lack of inspection. So the credit control, on the one hand, couldn't ensure the credit supply a better quality, on the other hand, it made it difficult for many development plans to secure necessary capital and produced bad effect on the economic development.

**5. Reallocation of funds**

In other countries, the central banks, acting as lenders of last resort, usually supply loans at discount rate to commercial banks. In the past, the State Bank used to reallocate capital to state-run commercial banks and charge an interest rate that equivalent to 60%-85% of the maximum lending rate charged by commercial banks. But since the beginning of 1995, the State Bank has charged the same maximum lending rate as commercial banks did, for loans supplied to both state-run joint stock commercial banks.


But because deposits in commercial banks have increased remarkably and they could supply loans to one another, so from the beginning of 1995, the State Bank didn't have to reallocate capital to any commercial bank except for Vũng Tàu and Tân Việt commercial banks which have once faced the danger of insolvency so they have had to mortgage an amount of Treasury-bills to the central bank. Fortunately, their troubles were over and they didn't need any loans. In future, the State Bank had better supply loans at discount rate and carry out open-market operations.

**6. Open-market operations**

These operations have been carried out by foreign central banks to realize the monetary policy. In Vietnam, the central bank didn't do the same but issued the State Bank bonds and offered T-bills for sale. Since the beginning of 1996, the State Bank has issued VNĐ2,000 billion worth of the State Bank short-term bonds at an interest rate of 0.7% a month. This activity therefore has produced no remarkable effect on the market.

Since June 1995, the State Bank, in cooperation with the Ministry of Finance, has made 9 issues by tender (4 times in 1995 and 5 times in the first half of 1996) for T-bills. By doing so, the interest rate was reduce from 18% to 8.4% a year, that is, the Treasury has to pay smaller interest to the public. However, the total face value of T-bills offered was rather small (VNĐ300 billion in 1995 and 250 billion in 1996). Naturally, this depended on the Treasury's need for money, but this deed didn't contribute much to the realization of the monetary policy.

**7. Inter-bank market**

The inter-bank domestic currency market came into operation in 1992, and the inter-bank foreign currency maket in October 1993 and attracted 40 members among 87 qualified ones. Operations in these market have helped to reduce the interest rate, from 27.6% a year in 1993 to 10% in 1996.

The State Bank had better take measures to attract all 87 members, prevent commercial banks from borrowing directly from other banks and help the inter-bank market operate regularly because the inter-bank rate can regulate other rates and encourage competition between commercial banks.

Vietnam is in the transition to the market economy, so all instruments couldn't be manipulated as in other countries. But many conditions have come into view and enabled the central bank to use certain instruments according to international practices. At the same time, the State Bank must control member banks more strictly and apply sanctions properly with a view to implementing the monetary policy perfectly■