FOREX MARKET LIBERALIZATION IN THE TREND OF INTEGRATION

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In July 1, 2002, the Governor of the State Bank of Vietnam (SBV) decided to expand the forex trading band of credit institutions for most of terms, for example, up from ± 0.10% to ± 0.25% for spot dealings; from ± 0.40% to ± 0.50% for forward dealings in 30 days; from ± 2.35% to ± 2.5% for more than 90 days...This is the fourth time since 1999 until now the SBV governor made such a decision. This modification meets requirements of credit institutions as well as enterprises which want forex trading with banks and are not affected by a narrow band as before. Credit institutions also highly appreciate this alteration because it reduces administrative regulations restricting their business autonomy. At the same time, the SBV's decision is heading for the forex market liberalization in line with international common practice, especially Vietnam is undertaking fully its commitments in the Vietnam-US trade agreement and on the road to WTO...

After a month of implementing the new regulation, the exchange rates on the three markets are rather stable, removing the fear that the governor's decision will spark off false price hike. In late July 2002, the exchange rate of commercial banks and in the free market stood around VND15,300 per dollar, up 1.13% as compared to the year beginning; in particular, there was no significant gap between exchange rates of these two markets.

In most of international markets, the forex market has been liberalized, commercial banks, forex traders proactively exchange and trade in foreign currencies in accordance with the market demand and supply. The central bank makes interventions only when really necessary, purchases or sells a certain kind of foreign currency in order to prevent sharp appreciation or steep depreciation of its currency. For example, when yen is much higher appreciated against with US dollar, the Bank of Japan (BOJ) finds it essential to sell yen and buy dollar. The volume of yen for sale may be lower than that announced previously but its huge psychological effects relieve strains in the market; and vice versa the BOJ may sell dollar and buy yen.

In our country there are now three forex markets: interbank forex market, forex trading market between credit institutions and free market.

The interbank forex market has been established in early years of the 1990s, and operational for about ten years. This is a marketplace for commercial banks' trading in foreign currency and the SBV to play as the last trader undertaking interventions in the market. The exchange rate established in this market is announced daily by the SBV. It is also a base price for credit institutions to set specific exchange rates in their trading within the permitted band. Nevertheless, since the market still faces limitations, especially SBV's inflexible interventions, sometimes sellers have no purchasers, as a result, the trading volume of foreign currency in this market remains modest, only some millions of US dollars per day on average. Many commercial banks are members of the market but usually stand outside and show no dealing. Therefore, the exchange rate established on the interbank forex market did not yet reflect its real value.

In the forex trading market, credit institutions are permitted to trade foreign currency with customers which are mainly enterprises. These enterprises have to sell 30% of their greenback earnings to banks. Moreover, their customers include foreign visitors. Vietnamese individuals almost have no forex dealing with banks due to inappropriate exchange rate and policy.

Table 1: Periods of changes in forex trading band

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<tr><th>Term</th><th>From Feb 26, 1999 to Aug 30, 2000 (%)</th><th>From Sep 1, 2000 to Sep17, 2001 (%)</th><th>From Sep 18, 2001 to June 30, 2002 (%)</th><th>From July 1, 2002 until now (%)</th></tr>
<tr><td>None</td><td>0.10</td><td>0.10</td><td>0.10</td><td>0.25</td></tr>
<tr><td>30 days</td><td>0.58</td><td>0.20</td><td>0.40</td><td>0.50</td></tr>
<tr><td>31-44 days</td><td>0.87</td><td>0.40</td><td rowspan="6">1.50</td><td rowspan="2">1.20</td></tr>
<tr><td>45-59 days</td><td>1.16</td><td>0.40</td></tr>
<tr><td>60-74 days</td><td>1.45</td><td>0.45</td><td rowspan="2">1.50</td></tr>
<tr><td>75-89 days</td><td>1.75</td><td>0.65</td></tr>
<tr><td>90-104 days</td><td>2.04</td><td>0.79</td><td rowspan="6">2.50</td></tr>
<tr><td>105-119 days</td><td>2.33</td><td>1.14</td></tr>
<tr><td>120-134 days</td><td>2.62</td><td>1.26</td><td rowspan="5">2.35</td></tr>
<tr><td>135-149 days</td><td>2.92</td><td>1.38</td></tr>
<tr><td>150-164 days</td><td>3.21</td><td>1.38</td></tr>
<tr><td>165-179 days</td><td>3.50</td><td>1.48</td></tr>
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The total turnover of this market is over US$10 billion per year. The exchange rate is based on the interbank rate plus a percentage within the band permitted. In such dependence, the exchange rate flexibility on the market is also poor and not close to the rate on the free market. It has fewer effects on modulating the exchange rates on the unofficial market.

Forex trading in the free market is conducted between individuals, between individuals and private enterprises, including foreigners. According to the SBV's latest survey with the JICA's assistance, the combined forex trading volume of some 200 Hà Nội-based businesses amounts to US$10 million per day, accounting 50% or 33% of the total in this market. One private business is ready to sell US$1 million without prior notice. Forex traders in Hà Nội are mainly jewelry shops, clustering on Streets of Hà Trung, Lương Văn Can, Chả Cá...I have ever sold US$20,000 to a jewelry shop on Hà Trung Street to buy T-bills with attractive interest rates.

The exchange rates of private shops are very flexible, even change many times a day. Many Vietnamese having greenback or wanting to buy dollar for overseas travel, work, study or medical treatment have their demand satisfied at private shops. Many private enterprises wanting hundreds of thousands, even millions of dollars to pay for their imported raw materials also seek private traders. Therefore, although the trading volume in the free market is much lower than that in the official market, its exchange rate really reflects the market value and place pressure on exchange rates of credit institutions. In case the permitted trading band is very narrow, this pressure is strong, especially in terms of psychological effects. Since the band was widened in July 2002, this pressure and psychological effects have been relieved. Furthermore, the exchange rate gap has been bridged, even the official market rate go down slightly, especially in the situation that US dollar is depreciated against euro and yen.

The above evidence shows the SBV is required to soon liberalize the forex market, cancel administrative regulations, make the same interventions as other central banks in the world, as well as use earnings from oil export for this task. It should consider abandoning provisions that Vietnamese citizens shall apply for their carrying dollar abroad at SBV branches when they go abroad for study or medical treatment. At the same time, the regulations on the proportion of foreign currency earnings that enterprises must sell to banks should be cancelled. Moreover, the required reserve ratio of dollar deposits should be reduced to one-third of the current level in order to increase dollar deposit interest rate and thus attract the people's greenback to banks for investment projects beneficial to the country. Commercial banks should be given favorable conditions for promoting their forex dealing competence.

In the trend of economic globalization, the integration of money and forex markets is inevitable. Therefore, the centrally-planned mechanism and administrative measures should be removed for smooth capital flows and logical establishment of interest and exchange rates in line with requirements of the market where the central bank still make interventions following the country's economic development strategy. ■