The SBV effort, however, couldn't reduce the gap between the supply of and demand for foreign exchange. Without its effort, the exchange might fall and commercial banks suffer the surplus of the dollar and shortage of the VND. The exchange rate was VND16,060 to the dollar at the beginning of 2007, VND16,086 in October and somewhere between VND16,036 and 16,038 in January 2008 falling by 0.1% compared with the rate at the early 2007 and much lower than the official rate of 16,125 publicized by the SBV. If the SBV keeps buying the dollar, it should increase the money supply causing the inflation to rise. Due to the shortage of the domestic currency, the inter-bank interest rate on overnight loans in the VND rose by 12% a year at times, or even 18% a year, much higher than the ordinary lending rate. By its open market operations, the SBV supplied some VND10,000 billion to commercial banks but this effort failed to reduce the shortage. At present, commercial banks have to take various measures to mobilize deposits in the VND, such as higher interest rate and better sale promotion with the result that the lending rate is higher making the danger of higher inflation rate more serious.

The above analyses show that implementing the monetary policy requires long-term, proactive and scientific strategies appropriate to international practices. Experience from surrounding countries such as the Philippines, Thailand and China are very useful because they usually face the same problems as Vietnam's but they could deal with them successfully, especially in forcing the domestic currency as the only legal tender. And as a result, all foreign visitors have to exchange their currencies for the domestic one.■

# Inflation and Measures to Curb It

by Dr. NGUYỄN ĐÌNH LUẬN

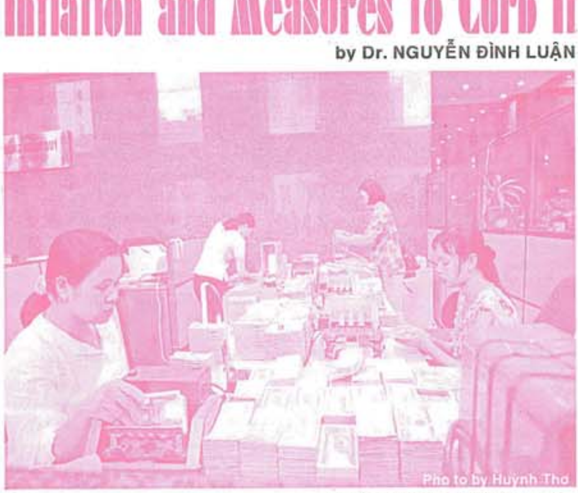

Photo by Huỳnh Thơ

## 1. Causes

Inflation may come from different causes, or combination of various factors, not only monetary and simply economic ones. Realities show that the inflation takes place frequently because of social events or political and economic contradictions. During periods of economic stability, the inflation depends on public mentality. It's reasonable to adopt the term of "expected inflation." If groups or leading economic players expect some expected inflation, it may take place because they are ready to raise market prices to make for it causing an inflationary spiral. That is why the government always plays an important role in stabilizing the economic growth, building the public confidence and curbing the inflation. Its role is not to regulate directly the market prices but to create a stable and trustworthy environment for economic development, prevent internal contradictions and limit external effects, and particularly take necessary measures when the inflation appears.

Let's return to causes from fluctuations in prices. Numerical data of rises in the CPI show that, the rises in the CPI in Decembers in 2004 and 2005 were higher than the annual rise in the CPI compared with the corresponding period if previous year while everything took the opposite direction in 2006 – the annual rise in the CPI was higher than the rise in December as compared with the previous December.

In 2007, the CPI in September increased by 7.32% compared with the previous December and the CPI in the first nine months rose by 7.53% over the corresponding period in 2006. Patterns of changes in the CPI in the last quarters of the past few years allow us to predict that the CPI in December 2007 over the previous December may rise by 8.2% - 8.5%.

The rises in the CPI in the past few years come from many causes and some of them are the following:

a. Monetary cause: Some experts are of the opinion that the rises in the CPI in 2007 come

**Table 1: CPI in December and Annual CPI compared with the corresponding period of previous year in 2004-06**

| Year | Rise in the CPI in December compared with the previous one | Rise in the CPI compared with the previous year | Change | GDP growth rate |
|---|---|---|---|---|
| 2006 | 6.6 | 7.4 | 0.8 | 8.17 |
| 2005 | 8.4 | 8.3 | - 0.1 | 8.44 |
| 2004 | 9.5 | 7.7 | -1.8 | 7.79 |

from increases in the money supply when the SBV bought a large volume of foreign exchange. Degrees of effects cause by the increased money supply must be examined in order to choose effective measures aiming at different objectives:

- In the past few years, the growth rate depended a lot on consumption and investment while the net export played a minor role.

- In 2007, the economic growth was due to higher consumption while the gross investment was lower than the one of the corresponding period and the net export reduced remarkably. This reflects the fact that the money supply was increased to support the economic growth. For example, pay raises increased the money supply and production cost; reduction in tax take led to increases in the money supply and encouraged the production; and subsidies to state-owned companies and banks also meant increasing the money supply.

- Fast development of the stock exchange also helped increase the money supply: increasing incomes of certain groups because prices of stocks were higher than value of companies. Another factor is the rise in the foreign indirect investment when foreign investors changed foreign exchange for the domestic currency and sent it to local companies. This move led to increases in the money supply.

b. Supply- demand relation: Prices of imported raw materials rose remarkably in 2007 (steel and iron by 20.5% and fertilizer by 7.7% for example). Imported raw materials account for 65% - 70% of Vietnam's basket of imports, so the prices on the domestic market are certainly affected greatly by fluctuations in prices on the international market.

c. Existence of monopolies defects in the distribution network: This situation caused the production cost to rise (especially prices of medicines and milks in recent months).

d. Public mentality: Rises in and adjustments to prices of fuel and electricity in 2007 increased the production cost of many essential goods causing great effects on the public mentality and their disposable incomes.

However, prices in developing countries tend to be lower than ones in developed countries, so the prices tend to rise when developing countries integrate into the world market.

### 2. Some measures to curb the inflation

- The Government should increase public investment and promote the production of essential goods, remove monopolistic advantages held by state-owned corporations, and beef up the mechanism for improving efficiency of major investment projects and preventing waste and corruption.

- Injection of money to fields or operations that are not necessary or important to the economic growth must be stopped, such as supply of loans for investors in the stock exchange or supply of loans in foreign exchange to companies. The exchange rate must be regulated by adjusting it to real values in order to improve the balance of trade. Banking authorities had better limit unnecessary conversion from foreign exchange to the domestic currency and vice versa in order to maintain stability of the monetary market and limit fluctuations in prices of imports.

- The privatization program must be accelerated in order to attract more idle money from the public, reduce the public expenditure on subsidies, force state-owned companies to improve their performance and increase the supply of goods.■


Photo by Huynh Tho