MONEY SUPPLY AND THE DANGER OF INFLATION

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Inflation, as an increase in the general level of prices, could be demand-pull or cost-push inflation, or caused by excessive creation of money.

As for the cost-push inflation, it couldn't be seen as a danger because the market economy in Vietnam is becoming increasingly stable under the control of the government. Factor input cost can hardly rise. At times, attention has been paid to increases in prices of some services and goods supplied by monopolists. For example, increases in prices of power, fuel, post and telecommunication fees made the general level of prices rise. Or changes in the exchange rate make imported raw materials dearer and also lead to the cost-push inflation. However, these problems have been solved recently when Vietnam tried to integrate into the regional market.

When the economic development is well under control, there is almost no chance for the demand for certain goods or services to excess the supply potential of the economy. The recent real estate fever experienced in Hà Nội and HCMC has only affected the middle and upper classes but it couldn't lead to inflation. The stability of the price index in the past few years reflected this tendency.

The situation makes many people think that the increase in the money supply is the main cause of the inflation. The following facts seem to support their argument.

- Up to the end of June 2002, the volume of credit supplied by the banking system was twice as much as the total bank deposit. Up to the end of July 2002, the total loan increased by 15.4% as compared with January while the planned increase was only 22% for the whole year. Many experts predicted that the increase by the year's end will be some 30% because the demand for bank loan usually becomes greater when the Lunar New Year is approaching.

- Up to the end of July 2002, the overdue debt reduced to 8% from 13% two years before but the volume of overdue and bad debt was still big. In addition, decreases in proportion of overdue debt were due to formation of reserve fund while proceeds of mortgaged assets equaled only 22.5% of total value of assets allowed to be sold by court.

- In the first half of 2002 the SBV through its open market operations supplied over VND5,300 billion to banks as compared with VND3,200 billion supplied during the whole 2001. The SBV also increased the money supply through other operations such as trade in foreign exchange, supply loans to government programs, etc. Remember that in the first half of 2001, the SBV injected no money to the economy.

- In July 2002 the Government decided to provide VND7,840 billion in form of special bonds for state-owned commercial banks to increase their registered capital, and planned to supply from VND1,000 to 2,000 from fund controlled by the Bank for Investment and Development. So it's estimated that the total loan by the banking system would reach VND500,000 billion by the year's end. The danger of inflation becomes clearer.

- In July 2002 the Government also allowed the SBV to buy all T-bills left after auctions. This was a way in which the SBV lend money to the Government. In addition, the PM tended to allow the SBV to increase the money supply by VND100 billion to lend to the Bank for Industry and Commerce and form the fund for student loans when the new school year was round the corner. These decisions also made the danger of inflation nearer.

Many local and foreign experts agree that it takes from six month to a year to see effects of increases in the money supply and determine whether they cause inflation or not. But we had better keep analyzing with a view to predicting possibility of inflation.

To carry out Decision 1627/2001/QĐ/NHNN made by the SBV Governor on Dec. 31, 2001 providing rules on the supply of credits by banking institution, Vietnamese commercial banks since early 2002 have applied new lending procedures, overcome shortcomings and defects in old lending mechanism and made banking services more suitable to international practices. In the new mechanism, the lending procedure is simpler and loan officers enjoy more autonomy and bear fuller responsibility for their decisions. After a series of lawsuits relating to banking officials, most loan officers have become more careful and law abiding when carrying out their operations. General level of banking officials has been improved and most banks could provide a wider range of services. And as a result, the banking business developed well and safely in the first half of 2002.

In the first half of 2002, the economy made good progress: no natural disaster happened; a lot of companies were established according to the new Companies Law; the public sector has been restructured; borrowing plans by companies are prepared carefully; large-scale farms – especially fish ones- gained big profits; more and more factories were built in EPZs and IPs; both agricultural and industrial sectors developed steadily; the government's demand-stimulation programs started to produce good results, etc. These developments led to greater demand for capital and bank loans; and idle money is quickly turned into investments.

Real estate is recognized as a commodity which could be traded or exchanged. A lot of money has changed hands on the realty market. The general level of price on this market made a twofold or threefold rise in the past few years while the gold price rose by 18% - 22%. That is why the demand for negotiable instrument became greater.

Over US$1 billion of immigrant remittances was sent to Vietnam in the first half of 2002; along with wages in foreign exchange paid to Vietnamese and foreign laborers working for foreign institutions and increasing tourist receipts gained by agencies in Vietnam. This volume of foreign exchange became negotiable instruments that are used a legal tender like the domestic currency. The trade in foreign exchange also demand the same volume of domestic currency. These factors help increase the demand for the domestic currency from banks.

Since April 1, 2002, bank bills were withdrawn from circulation, which requires an additional volume of domestic currency.

Increasing the registered capital of banks is a necessary condition for increasing the volume of credit but not a sufficient one. The questions are whether banks can attract idle money from the public and potential customers have feasible borrowing plans or not.

The SBV employs various instruments and operations to regulate the money supply: reserve requirements, discount rate, open market operations, exchange control... It also supplies credit to the government by buying T-bills through auctions, which is appropriate to international practices and State Bank of Vietnam and National Budget Laws.

The increase in money supply used for operating the Student Loan Fund is only small part of the planned volume approved by the National Assembly and the Government.

One of important causes of fast increase in the total bank loan is the fact that many projects to borrow foreign exchange by local commercial banks started to receive the money they need, so the banks could pay for imported materials and realize major development programs.

Foreign experience and reality in Vietnam show that the banking authorities had better adopt an easy money policy along with a strict supervision mechanism in order to accelerate the economic growth and create more jobs. At present, the Government and SBV have carried out such a policy and there is no need to worry about the danger of inflation. ■