A Tight- Money Policy Adjusted to National and International Macroeconomic Changes

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When analyzing the implementation of the monetary policy and the banking service, it's necessary to examine changes in the socioeconomic lives at home and abroad, because they affect greatly the building and implementation of the monetary policy and business strategies of commercial banks as well. The operation of the banking sector and implementation of the monetary policy in 2008 were affected profoundly by the following events.

- International situation:

+ The global financial crisis reached its worst level in the past 80 years. It started with the subprime mortgage crisis in the United States that forced some 20 American banks of various sizes to go bankrupt, shut down, or to be sold; and the US Government had to launch a US$700 billion financial support program and inject US$800 billion to save the economy. Many European banks in the UK, Germany, Belgium and the Netherlands suffered the same fate. The EU had to offer an aid package of US$2,500 billion. In Asia, a Japanese well-established insurance group went bankrupt. Japanese and South Korean governments had to spend hundreds of millions of dollars on saving the financial markets and stimulating economic activities.

+ In the first half of 2008, high inflation rates were reported from all over the world, and the average rate reached its highest level in the past 20 years. Most central banks had to adopt tight-money policies, increase the base rates and required reserve ratios. As from September 2008, however, for fear of recession caused by the financial crisis, many central banks quickly switched to cheap money policy, and cut base rates and reserve ratios, and introduce bold financial policies to stimulate the economic growth.

+ Commodities and foreign exchange market fluctuated in a complicated manner. In the first seven months of 2008, the dollar fell against the euro and other hard currencies. It its lowest level, a euro was equal US$1.6. From August 2008 on, however, the dollar rose again and in late October, a euro was equal US$1.4. Similarly, the price of crude oil reached its peak at US$147 a barrel in July 2008, and fell to US$44- 46 per barrel in December, the lowest level in the past four years. The gold price from its peak of US$940 per ounce fell to US$700 in December. The rice price fell from US$1,200 to 400 a tonne in 2008. Prices of gas, steel, rubber and coffee changed in the same direction, rising high in the first seven months and fell drastically in the last quarter.

- Domestic situation:

+ Natural disasters took place in many provinces. In the first quarter, the longest cold spell in the last 12 years in the North caused damage to crops and animal husbandry. Floods, diseases among cattle and livestock happened in various provinces.

+ Due to fluctuations in world market for commodities, foreign exchange, stocks and gold, prices of food, gold, fuel, steel, rubber, cashew nut, coffee and cement skyrocketed in the first seven months, and the CPI experience its highest hike in the last 16 years. From August on, these prices started to fall, and some of them fell quickly. The CPI rise also slowed down and it fell in October and November. Purchasing prices of farm products for export also fell considerably.

Generally, governments, departments of finance and central banks in many countries have left tight-money policies aiming at curbing the inflation for cheap money ones in order to fight against effects of the financial crisis spread out from the United States.

Theoretically, the monetary policy always aims at controlling the inflation, stabilizing the value of currency and encouraging the economic growth. In reality, however, it doesn't always achieve all objectives. Sometimes, authorities have to trade off this one for another. In Vietnam when facing these fluctuations, the implementation of the monetary policy in 2008 was adjusted to them and could be divided into three distinctive stages:

- A tight- money policy was adopted in the first eight months to reduce the inflation.

- The monetary policy became more flexible in the next two months to ensure social welfare and economic growth besides controlling the inflation rate.

- A less tight-money policy was applied in the last quarter to prevent the recession caused by the global financial crisis.

Analyses of each stage are as follows.

1. Tight money policy in the first eight months

a. Tightening measures:

One of eights measures to "curb the inflation, stabilize the macro economy, and ensure the social welfare and sustainable development" introduced in mid-March 2008 in to adopt a tight money policy. To achieve this aim, the SBV increased the interest rate to encourage saving and reduce investment by withdrawing money from circulation. Measures taken by the SBV were as follows:

In January 2008, the SBV extended the required reserve to deposits of maturity of more than 24 months, instead of limiting to 24-month deposits only. On Feb. 1, 2008, the SBV required banking institutions to keep total loans to investors in the stock market under 20% of their chartered capital. From February on, the required reserve ratio was set 1% higher; the base rate rose from 8.25% to 8.75% a year; the refinancing rate from 6.5% to 7.5% a year and the rediscount rate from 4.5% to 6.0% a year. Previous rates have applied since December 2005 and stayed stable for two years. These increases aimed at dealing with the high inflation rate.

On March 17, 2008, 41 banking institutions had to buy VND20,300 billion worth of compulsory bills from the SBV, and three state-owned commercial banks spent VND3,000 billion each on these bills. On April 10,

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2008, the SBV decided to limit the supply of loan in foreign exchange.

On May 19, 2008, the base rate rose from 8.75% to 12% a year and commercial banks were supposed to set the lending rate lower than 150% of the base rate. On June 11, 2008, the base rate rose to 14% a year, the discount rate rose from 11% to 13% a year, and the refinancing rate from 13% to 15% a year. On July 11, 2008, the SBV issued rules of operations of exchange offices, especially jewelry companies and shops, with a view to preventing rises in the price of the US dollar.

b. Effects on the interest and exchange rates and the money market:

In early 2008, and especially in February, the SBV started implementing the tight money policy in an effort to curb the inflation as required by the Government. In such a situation, commercial banks had to adjust their deposit rate frequently to ensure the supply of capital and limit commercial loans. From mid-February to late August 2008, both deposit and lending rates kept rising when commercial banks competed for more deposits. In other words, the biggest effect of the tight money policy was the race for more competitive deposit rates. On May 19, 2008, the rate for deposits in the VND was only 12% at most. From June 11, 2008, all commercial banks increased their deposit rates and they rose day by day; from 17% - 17.5% to 17.6% - 18%. Banks also offered various incentives to attract prospective depositors, especially the ones with big and long-term deposits.

The rate for deposits in foreign exchange, usually the dollar, was also high, from 6.5% to 7.0% a year. The highest rate was found at Hà Nội Housing Bank: 8.0% a year for 12-month deposits. The Vietnam Bank for Foreign Trade issued certificate of deposits in the dollar with a rate of 7.2% a year.

The interest rate on the inter-bank market rose to 40% a year at times in March and April 2008, or over 30%. From mid May to mid-June it also rose high: the rate was 19.85% a year for 1-month loans in the VND; 19.0% for 2-week loans; and 19.29% for 1-week loans. Facing

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these fluctuations, the SBV had to intervene through open market operations by which frequency of operations, and size and scope of transactions were all expanded with the interest rate well under control. These operations ensured liquidity and disposable capital for commercial banks, and at the same time, helped control the interest rate as required by the monetary policy.

When the deposit and inter-bank rates rose, the lending rate inevitably rose, with its highest limit at 21% a year, along with the fact that commercial banks limited the volume of credit, which forced companies and individuals to reconsider plans to get bank loans, adjust their business plans, or postpone some projects. All of these changes also helped curb the inflation.

As for the exchange rate, in the first eight months of the year it changed in opposite directions: In late February and early March, it fell sharply and led to some surplus of the dollar. Companies found it hard to sell foreign exchange to banks or they had to accept some charges. From late May to mid-June, it rose high, and companies could not buy it from banks, or had to accept some charges. However, interventions of the SBV made the exchange rate and the foreign exchange market gradually stable.

For most companies, however, especially small and medium enterprises and exporting companies, securing bank loans at reasonable interest rates was still a problem that required the SBV to take appropriate measures to improve the situation as soon as possible.

2. A flexible tight money policy to support companies

a. Measures:

Changes at the macroeconomic level made the rise in the CPI slow down in August and September 2008. The inflation rate became controllable but the production still met with difficulties. The Government required the SBV to implement the tight money policy in a more flexible manner and it made the following decisions:

- As of Sep. 1, 2008, interest on the required reserve in the VND was raised from 1.2% to 3.6% a year.

- As from Oct. 1, 2008, the base rate was fixed at 14% but the rate on required reserve was allowed to rise from 3.6% to 5.0% a year.

- On Sep. 25, 2008, the SBV Governor allowed SBV compulsory bills sold in March 2008 to be mortgaged or discounted to the SBV for capital, or used as an instrument for the open market operations.

- As from Oct. 21, 2008, the SBV reduced the base rate in the VND from 14% to 13% a year; cashed in SBV compulsory bills sold in March 2008; reduced the refinancing rate from 15% to 14% a year, rediscount rate from 13% to 12%, and the overnight rate on the inter-bank market from 15% to 14%. The rate on required reserve was also raised from 5% to 10% a year.

b. Objectives of the monetary policy in this stage and the money market after the flexible tight money policy:

The main objective of the policy was still to curb the inflation. Although the CPI lowered in October, it still stayed at a high level for the year. In implementing the monetary policy, the SBV kept maintaining a high required reserve ratio to limit the supply of loans by banks and withdraw money from circulation. The implementation was considered as more flexible when the interest rate on required reserve was set higher to reduce the overheads of commercial banks; and other rates were also cut to allow banks to offer lower lending rates. In addition, the cashing in compulsory bills by the SBV and allowing the banks to use the bills to access SBV open market operations also satisfied partly the demand for cash of banks.

These positive effects of the flexible implementation of the monetary policy made the money market and banking activities return to their routines in the third quarter of the year. Both deposit and lending rates offered by commercial banks started falling after cuts in the base rate and required reserve ratio by the SBV. In early November, the interest rate on 12-month deposits fell to somewhere between 11% and 14.8% compared with its June peak of 16- 17%; and the rate on 3- and 6- month deposit fell to 13% - 15% from 18% - 19% while the 12-month deposit in the dollar earned only 5% - 5.8%.

The lending rate also reduced accordingly: a cut of 1.5% or 2% was widespread. In November 2008, the lending rate in the VND fell from its peak of 21% to 14% - 16.5% while the lending rate in the dollar reduced to somewhere between 6.5% and 8.5%. Commercial banks started looking for borrowers, especially exporters with stable market shares. However, the lending rate was still high compared with their profitability ratio. The lowest lending rate registered in November was 15.5% but not all companies could afford such lending rate.

In this stage, the open market operations went well and intervened effectively in the interest rate and liquidity of banks. The exchange rate and foreign exchange market became more stable than in the previous stage.

3. Loosening the tight – money policy

a. Objectives and measures:

Objectives of this stage were to reduce the inflation rate (the CPI in October and November were lower but the 2008 CPI would be still high), and struggle against the recession caused by the global financial crisis and natural disasters in Vietnam. Unlike the flexible implementation of the tight- money policy, the change to a cheap -money policy was carried out by cutting all rates to the bone and reducing the required reserve ratio, which allowed banking institutions to increase the supply of credit at a reasonable rate of interest. Within a month, from early November to early December 2008, the SBV cut important rates three times, and cut the required reserve ratio two times according to a series of decisions on these matters.

- As from Nov. 5, 2008, the base rate in the VND reduced from 13% to 12% a year; the refinancing rate from 14% to 13%; the rediscount rate from 12% to 11%; rate charged by inter-bank payment system from 14% to 13%. The SBV also took a 1% cut in the required reserve ratio for deposits in the VND and a 2% cut in the reserve ratio on deposits in foreign exchange.

- As from Nov. 7, 2008, the band of the exchange rate on foreign exchange traded on the cash market was raised from ±2% to ±3%.

On Nov. 20, 2008, the SBV Governor issued three Decisions to cut the base rate from 12% to 11%; the refinancing rate from 13% to 12%; the rediscount rate from 11% to 10%; the overnight rate on the inter-bank market from 13% to 12%. The reserve ratio for call deposits and deposits with maturity of under 12 months in the VND with urban banking institutions reduced to 8%; with Bank for Agriculture and Rural Development: 5%; with private banks in rural areas, Central Credit Fund and cooperative banks: 1%. The reserve ratio on 12-month deposits in the VND with the three groups of banking institutions was 2%, 1% and 1% respectively.

On Dec. 3, 2008, five Decisions were made and came into effect as of Dec. 5, 2008. They reduced the base rate from 11% to 10%; the refinancing rate from 12% to 11%; the rediscount rate from 10% to 9%; the overnight rate on the inter-bank market from 12% to 11%. The interest rate on required reserve in the VND fell from 10% to 9%. The lending rate offered by People's credit funds should not exceed 165% of the base rate.

As from December 2008, the required reserve ratio for call and 12-month deposits in the VND with urban banking institutions fell to 8% (for deposits in foreign exchange: 7%); deposits with BARD: 5% (deposits in foreign exchange: 6%); and with private banks in rural areas, Central Credit Fund and cooperative banks: 1%. The reserve ratio on 12-month deposits in the VND with the three groups of banking institutions stayed unchanged: 2%, 1% and 1% respectively. The required ratio for 12-month deposits (and longer) in foreign exchange with urban banks was 3% and rural banks: 2%.

In this stage, the open market operations were maintained normally with a view to intervening into the disposable capital of banks and the market interest rate. The disposable capital of banks was higher than that in early 2008. The exchange rate and foreign exchange market experienced slight fluctuations but they were considered as stable in comparison with the previous stages in 2008.

4. Results of the implementation of the monetary policy in 2008

Firstly, the SBV implemented tight-money measures to curb the inflation according to PM instructions. Up to October 2008, the total means of payment only rose by 10.59% compared with a rise of 32% in late 2007; outstanding loan rose by 19.6% compared with a rise of 37% in late 2007. In the first 10 months, some VND35,000 billion were withdrawn from the circulation. Moreover, the foreign exchange reserve rose to some US$23 billion by late 2008.

Having paid full attention to the inflation control, the SBV could manage to change to the cheap-money in the last quarter when the situation at home and abroad was improved. At the same time, the SBV beefed up its control over the banking system, enhanced the credit quality and banking services in general, and limited the volume of overdue debt and loans supplied to investors in stock and realty markets.

Commercial banks could satisfy better the demand for capital by agriculture, export and construction sectors, especially unfinished construction projects. Up to the end of October, the total loan supplied to the private sector rose by 35% while the one supplied to the public sector only rose by 12.8%. The total loan supplied to producers rose by 34%, to exporters: 37%; and to peasants and rural residents: 27%. Particularly, the total loan supplied to poor families and the ones enjoying care from social policies reached VND27,000 billion increasing by 34%. They included nine million poor families and the ones under social programs that have received loans for the past five years; and now six million of them have not repaid yet. Such loans created jobs for some 1.9 million rural residents.

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In the college credit program, some 800,000 students received a total loan of VND6,061 billion. The Bank for Social Policy helped build some 820,000 works supplying fresh water to rural families.

By the end of October, 29 commercial banks gained rises of over 30% in their total loan compared with late 2007. The total loan supplied to investors in stock market reduced from VND25,200 billion in June 2007 to 6,200 billion in November 2008. In HCMC, the total loan to investors in real estate reduced VND85,905 billion. Of VND61,000 billion invested in real estate, 18,000 were in forms of fiduciary loans to civil servants based on their payrolls.

Secondly, the interest rate was adjusted reasonably with a view to ensuring interests of depositors, commercial banks and borrowers. As from May 19, 2008, the SBV applied a new mechanism for controlling the interest rate according to the State Bank of Vietnam law and certain articles of the Civil Code. Saving from the public rose by 34% by the end of October 2008 compared with a rise of 31% in October 2007.

Thirdly, establishment of new commercial banks was reviewed in order to ensure safety for the banking system. In 2008, private commercial banks Liên Việt, Tiên Phong and Nam Việt received licenses and came into operation. By the end of the third quarter, the SBV decided to stop granting new licenses to establish new banks and started studying new standards of joint stock commercial banks.

In March 2008, the SBV approved in principle the establishment of two foreign banks in Vietnam: The Hong Kong and Shanghai Banking Corporation and Standard Chartered Bank.

In August 2008, the Commonwealth bank of Australia opened its branch in HCMC and became the first foreign bank to run a branch after Vietnam opened the financial sector as required by WTO rules.

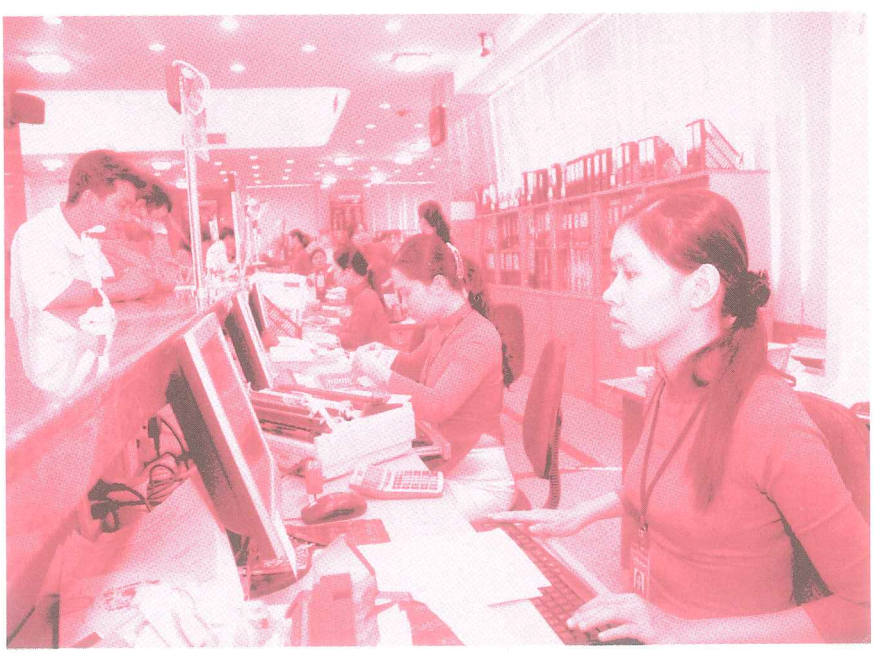
These developments showed that foreign banking groups believed a bright future for Vietnam. That is why they kept increasing their investment in Vietnam.

Fourthly, the SBV beefed up its control and supervision of the banking system. In mid- 2008, it inspected the credit quality in Hà Nội and HCMC. Up to the end of September, the overdue debt was VND35,000 billion equaling 2.92% of the total loan. Commercial banks had VND22,000 billion in their funds for risks. All banks gained profits higher than the level reached in the correspondent last year. It's expected that by the year's end, their funds for risks would increase, their profit might contract but no banks suffer losses. At the end of September, there were nine banks of small size (with the chartered capital of under VND1,000 billion) and they were asking for permission to increase their capital as required by banking regulations.

Fifthly, the SBV tried to adjust the exchange rate changes in market forces. The exchange rate control aimed at promoting the export. When the dollar fell in 2007, the VND was depreciated to support the export. In the first 10 months of 2008, the VND fell by 6% against the dollar for the same reason. In 2008, the supply of the dollar reduced at times because of fast increases in the trade gap and the SBV controlled the exchange rate according to directions from the Government.

5. Predictions and measures for 2009

It's estimated that the interest rate in 2009 will fall slightly as compared with the one in November 2008 and stay stable for the year. The supply of bank loans to development projects will be more flexible and competitive. The exchange will stable in spite of some minor rises in an effort to encourage the export.


Pho to by Huỳnh Tho

In my opinion, the SBV will keep operating flexibly instruments of the monetary policies and open market operations. Granting licenses to new banks will be strictly controlled. The monetary policy in the coming years should give priority to tasks of curbing the inflation and thrusting the economic growth. Instruments and operations of the monetary policy must be employed more flexibly and the main aim must be a stable exchange rate. Vietnam is still depending in foreign capital and raw materials, exporting farm products and natural resources, and suffering a high trade gap, so a slight depreciation of the VND can not promote the export but it may produce bad effects on the import and repayment of foreign debts.

Operation of commercial banks and other banking institutions will be more stable and effective; their competitiveness will be improved when the quality of their management is higher. In my opinion, the SBV had better beef up its inspections in order to ensure credit quality, especially loans to investors in the realty market, and prevent risks of various kinds.

It's estimated that the banking system will play an active and important role in thrusting the economic growth during the global financial crisis. And this system will gain higher rises in 2009. ■

Reference

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