

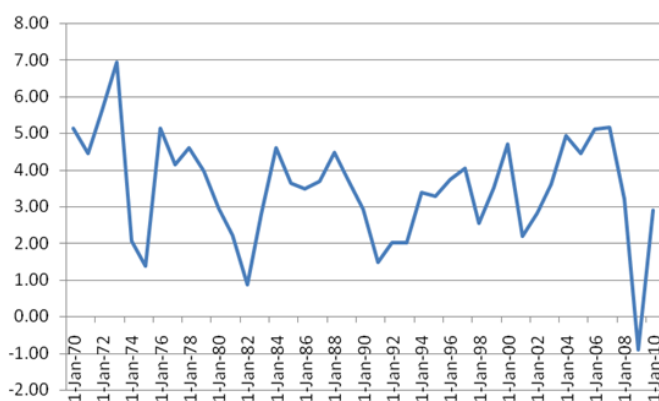
IMPACTS OF FINANCIAL CRISIS UPON THE VIETNAM'S ECONOMY IN 2009 AND SOLUTIONS TO THE MONETARY POLICY FOR 2010

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1. Retrospection of impacts of the 2007- 2008 financial crisis on the Vietnam's economy in 2009

The 2007-2008 financial crisis was triggered by the collapse of the United States' sub-prime lending market, resulting in the collapse of large financial institutions as well as weakening the whole economy. Many investors and depositors raised their doubts about the banking system, exposing banks to difficulties in capital mobilization. Accordingly, the interest rate of capital mobilization and loans was adjusted higher, affecting the production and investment of enterprises. Besides, reduction in spending made the situation go from bad to worse. The financial crisis then spread to the manufacturing sector, causing the global economic recession.

Figure 1: World average growth rate

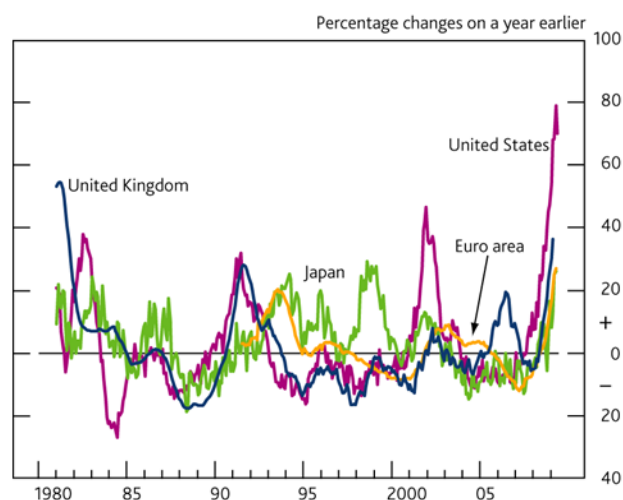


Source: IMF World Economic Outlook (WEO); WTO International Trade Statistics; and figures of Bank of England in 2009

If we look at on the stat, we can see that the world average growth rate sharply decreased from above 5% in 2007 backwards to 3.1% in 2008. This downward trend showed no sign of ceasing in 2009. According to the latest WB report, the world economic recession was set at -2.2% in 2009 and is anticipated to regain its augmentation from 2.7% to 3% in 2010.

Among indicators during the crises, the most noteworthy is the rate of unemployment in many countries. This rate increased by 40-80% compared with the same period of 2008, and showed no sign of plummeting in many crisis-stricken countries like the USA (10%), EU (10%), UK (7.8%), Japan (5.2%) and several of European countries.

Figure 2: Rate of unemployment of some crisis-stricken countries



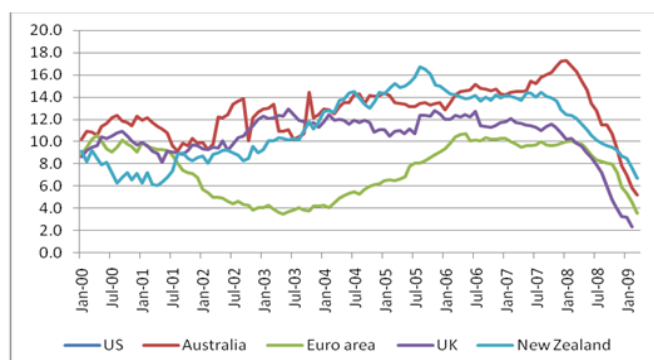
Source: OECD

Many giant bailouts were injected into the

economy by governments with a view to regaining a healthy economy and weathering the recession. The US Congress, in 2008, passed the US\$150 billion economic stimulus package designed for its flagging economy; and insured up to US\$700 billion of troubled assets. In February 2009, another stimulus package of US\$800 billion was approved by the US Congress. Many of other countries like UK, Japan, France and China did inject into their economies with the similar stimulus packages. Germany, for example, introduced a €500-billion growth plan to rescue its banking system. In November 2008, its cabinet fueled the economy with a €31-billion economic stimulus package, and a €50-billion package also generated in January 2009. At the same point, the European Central Bank (ECB) backed €500 billion so as to finance the capital-thirsty interbank market.

The below figure points out the credit growth of several countries in the world has plummeted to 2 or 4 percents. This is the lowest growth rate since the 2000s.

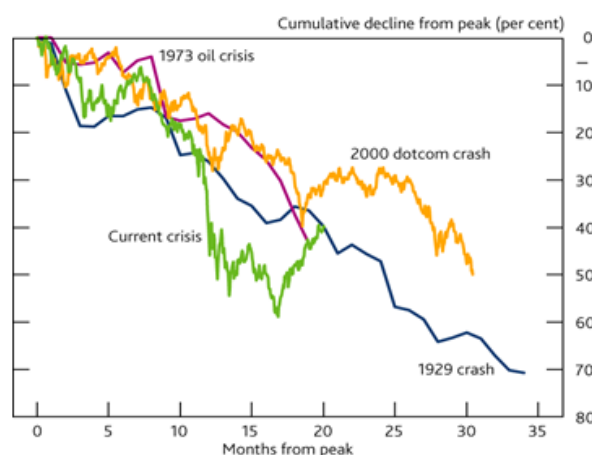
Figure 3: Credit growth of some countries in the world



Source: Bank of New Zealand 2009

Compared with the Great Depression or the 1973 oil crisis, although the current crisis had a great and broad scope of impact, it was curbed quite rapidly. Apparently, the cost of fixed assets, which had sharply plummeted by 50 to 60 percent for 10 to 15 months as of the crisis, was soon recovered comparatively. Meanwhile, it took more than three years to recover from the Great Depression and around two years for the 1973 oil crisis; the 2000 crisis also lasted over 30 months.

Figure 4: Cost of fixed assets in the world through the crises



Source: Global Financial Data & Bank of England

NB: The 1929 crisis occurred on Oct. 31, 1929; the 1973 oil crisis on Feb. 28, 1973; the 2000 Dotcom crash on March 27, 2000; and the current crisis on Oct. 11, 2007.

2. Impacts of the current crisis upon Vietnam's economy and measures taken

Prior to the current crisis, Vietnam had maintained an average growth rate at some 7.5% over the period 2000-2007. However, due to the impacts of the financial crisis, the Vietnam's stock market and its banking system encountered hardships, discrediting investors and depositors. Many of enterprises were on the brink of collapse when banks loans became more difficult to secure than ever. Besides, the world demand for consumer goods sharply plummeting caused bad effect on the export turnover and local production. In 2008, the Vietnam's growth rate was just at 6.2%, whereas the CPI was at 19.9%. One year later, although the health of economy partly got better, the GDP growth just reached 5.32%. The 2009 CPI increased by 6.88% compared with the 2008 and it was the lowest percentage over the six recent years (this index was 7.71% for 2004, 8.29% for 2005, 7.48% for 2006, 8.3% for 2007, and 22.97% for 2008).

The 2009 CPI was ranging around 1%, except the February and December saw the increase by 1%. Accordingly, the CPI of December 2009 jumped by 6.52% compared with the same period of 2008, lower than the target of 10% set by the National Assembly. In the context of the global fi-

nancial crisis, Vietnam has weathered rather successful, gaining a quite growth rate and keeping the inflation rate at a low level. It is also due to the good macroeconomic management.

Even though the budget deficit was manipulated, it accounted for 7% of GDP. The 2009 trade deficit decreased by 32.1% compared with the 2008, yet it made up US\$12.2bn equaling 21.6% of the gross export turnover (US\$56.6bn).

The monetary policy was adjusted flexibly before and after the crisis. In 2008, in order to weather the high inflation, SBV increased the base rate and required reserve, beefed up the credit control, and so on. When Vietnam's economy was magnetized into the global recession in the last two quarters of 2008, however, decreases in the base rate and required reserve ratio was executed by SBV, supporting banking institutions of low liquidity by re-financing and open market operations.

a. Interest rate policy:

In 2008, the SBV adjusted the base rate up for three times (from 8.25% up to 8.75%, 12% and 14% respectively), and down for four times (from 14% down to 13%, 12% and 11% respectively) with a view to loosening the monetary policies and preventing the downward trend of the economy. The maximum lending rate decreased from 21% to 12.75%; the credit growth of 2008 was kept at +22%, whereas the 2007 saw the increase of +54%. In 2009, SBV still employed flexibly instruments of the monetary policy to reduce the lending rate and enable banking institutions to extend credit. For example, the base rate on VND loans slumped from 8.5% to 7% with the maximum lending set at 10.5%; the refinancing rate was slashed from 9.5% to 7% per year and the discount rate down from 7.5% to 5% per year. The required reserve ratio was adjusted down from 6% to 3% for demand deposits in VND and fixed deposits with term shorter than 12 months; and down from 2% to 1% for VND accounts with term longer than 12 months.

The target growth rate for 2009 was adjusted down from 6.5% to 5% and the first demand stimulus package of VND143.000bn was injected into the economy to weather the recession and secure the macroeconomic stability and social welfare. Fiscal and monetary policies have well supported the economy, especially the interest-supporting

package of VND17.000bn, which helped increase the credit supply, production, consumption and investment in Vietnam. The growth rate in the second quarter of 2009 reached 4.5% compared with the 3.1% of the previous quarter; the third and fourth quarter of 2009 also saw the growth of 6.04% and 6.09% respectively. Accordingly, the GDP growth of the whole 2009 reached 5.32%, compared with the target of 5%. This is to say, the Vietnam's economy has been on the way of recovery and the 2010 GDP may even soar by 6% if suitable policies are adopted.

b. Exchange rate policy:

In order to overcome complicated upheaval on the global finance market as well as to facilitate the operation of domestic banking institutions and reduce the difference in exchange rates on free and official markets in 2008, the SBV extended the band on either sides the exchange rate to the dollar from $\pm 0.75\%$ to $\pm 1\%$, $\pm 2\%$ and $\pm 3\%$ in comparison with the interbank rate. Besides, to deal with an increased trade deficit in early 2008 that affected profoundly the macroeconomic balance, the SBV, on June 10, 2008, increased the interbank rate by 2% (from VND16.139 to 16.461 to the dollar). On Dec. 25, 2008, this interbank exchange rate increased by 3% and one US dollar equaled VND16.989. It created a new exchange rate for 2009, supporting export and curbing trade deficit as well as improving the balance of international payments.

On March 23, 2009, the SBV Governor promulgated the Decision 622/QĐ-NHNN, effective from March 24, adjusting the band of exchange rate from $\pm 3\%$ to $\pm 5\%$. This Decision would make the exchange rate more flexible and reflect the supply and demand of forex. Besides, it enabled banks and enterprises to take the initiative in working out their business plans for 2009. The SBV also sold more forex so as to meet the need for essential imports, stabilize the exchange rate and struggle against speculation of forex market.

Nonetheless, in order to get on well with the upheaval of the economy, the band of exchange rate was adjusted to $\pm 3\%$ on Nov. 26, 2009, and the interbank average rate for Nov. 26, 2009 increased by 5.4% compared with the day before. In addition, the base rate, refinancing rate and discount rate increased by 1% as of December 2009.

c. Demand stimulus package:

Thanks to timely and flexible direction of the Government, the banking system executed successfully the first demand stimulus package, in form of a subsidy equaling an interest rate of 4% for corporate loans, and this subsidy amounted to over VND450.000bn, accounting for some ¼ of the total credit supply of the whole banking system. This measure rescued a lot of enterprises, creating around 1.6 billion new jobs in 2009. At the end of 2009, the gross credit supply increased by 37.73%;

2009 proved that the Government controlled the consumer price effectively.

The global economic recession entailed the increase in unemployment and the decrease in the global aggregate demand and trade. The global exports dropped by -13.9%. However, Vietnam's export still reached US\$56.6bn. This figure is a decrease of 10% compared with the 2008; yet it is still considered as a success to a certain extent.

Table 1: Vietnam's macroeconomic data in 2001-2009

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009
M2 (%)	26	18	25	30	30	34	43	17	29
Credit (%)	22	22	28	42	32	25	54	22	38
CPI (%)	0.8	4.0	3.0	9.5	8.4	6.6	12.6	23.0	6.88
GDP (%)	6.90	7.08	7.34	7.79	8.44	8.23	8.48	6.18	5.32
Gross investments (%GDP)	35.4	37.4	39	40.7	40.9	41.5	45.6	43.1	42.8
ICOR	5.10	5.28	5.31	5.22	4.84	5.07	5.37	6.97	8.0
Budget deficit (%GDP)	4.7	4.5	3.3	4.3	4.9	5.0	5.0	5.0	7.0
Trade deficit (US\$ billion)	1.2	3.0	5.1	5.5	4.3	5.1	14.1	17.5	12.2

Source: SBV, GSO, authors' calculation

deposits at banking institutions increased by 28.7%, total liquidity rose by 28.67% and inflation rate was kept at 6.88%.

Glancing back to the 2009, we see that effects of the global financial crisis were extremely serious. However, the consequences were not as serious as expected. Some were afraid that the crisis would paralyze the global economy, even result in a worldwide economic recession, which might be greater than the Great Depression. In fact, the economy has been recovering its health. Although the global growth index fell to -2.2% in 2009, it is expected to inch up +2.7% in 2010. Thus, we can describe the curve of economic fluctuation as V-shape or √-shape. However, the fact remains that Washington and Beijing have tightened their credit control hindering the rapid recovery of the world economy.

Within the past 10 years, the 2009 GDP growth rate of Vietnam was of the lowest level, just around 5.32%. Yet, if we put it in the context of global recession, Vietnam managed successfully to weather the recession. The CPI of 6.52% for

3. Some financial and monetary solutions suggested for the post-crisis period

The 2010, the last phase of the five-year plan, marks a turning point in Vietnam's economy. The world economy is predicted to recover healthier, yet potential fluctuations are expected to get complicated. However, in order to accomplish targets of socioeconomic development for 2010, Vietnam needs to focus on prime issues of its financial and monetary policies.

a. Inflation control in short and long term:

In accordance with recent reports on CPI, an important indicator of inflation rate, the state control over inflation has gained certain achievements. However, to prevent the reflation and potential rise in market prices is not such an easy task for Vietnam in the post-crisis period.

The world economy has been recovering from the crisis, stimulating the growth of market demand. Such economic stimulus packages of the US, EU, Japan and China, among others, consequently causes the increase in prices of several of raw ma-

terials and machinery that Vietnam imports in large quantities. Cheap monetary policies and open fiscal policies being employed by Vietnam since 2009 also shoot the price up (GSO 2009). SBV should determine targets of price stability serving the sustainable development and employment. The inflation spectrum must be determined, especially its key points. A clear-cut target inflation is not necessarily to be determined, but we need to figure out an inflation rate suitable for price stability and situation of Vietnam in each period. Policies for accomplishment of targets must be considered thoroughly in advance, including their potential time-lag impacts on inflation when monetary policy and its instruments are changed. Thus, predictions of SBV play an important role in that they are fundamentals for decisions on relevant policies. For example, the inflation must be kept under 10% for 2010; 8% for 2011 and under 7% for years to come.

b. Interest rate policy:

The ECB, on one hand, is going to maintain the low interest rate of 1% until April 2010; and once the economy gets healthier, this rate will increase to 1.5%. Retaining a low interest rate aims at keeping a balance between economic growth and inflation as well as minimizing the reoccurrence of recession. On the other hand, ECB also has to maintain the interest rate and enhances the accessibility to bank loans since the overpriced Euro may impinge badly on the EU economic recovery and its competitiveness. Therefore, in addition to the requirements of securing the balance of monetary policy and inflation, EU's prestige, decrease in unemployment rate and control over social evils, the faint recovery of EU economy is the main factor affecting

ECB's low interest rate (Văn Thanh, 2010).

Meanwhile countries in Europe, Asia and the US have been applying a low interest rate with a view to ensuring the economic recovery, Vietnam's base rate has been set at a high level of 8% and on its onward trend. It may profoundly affect the economic recovery in the post-crisis period. However, the point is this low rate is just the mere administrative intervention while complicated changes in bank lending and capital mobilization show that the bank interest rate even exceeds the rate ceiling via lending fees and sales promotion programs. Virtually, a strict mechanism for regulating the interest rate will result in unnecessarily negative effects on the economy and hinder the administration of SBV. This is to say, the interest rate must reflect the balance between supply and demand, bank overheads; and depend on the types of borrower and sponsorship. Banks and customers need to have an open and transparent competition with a view to making psychological effect on economy. SBV had better manipulate the market by loosening or tightening the money supply using such instruments as discount rate, refinancing rate, required reserve and open market operations (OMO).

Besides, thanks to the liberation of interest rate, banks can extend its credit to markets, hospitals, and residential areas, etc., and gradually efface usury. Banks can offer suitable rates based on degrees of risk involved in lending and credit rating expenses rather than making some charge for loans based on a loophole in banking regulations. In the first two quarters of 2010, the mechanism will be executed step by step. Firstly, a ceiling on borrowing rate must be set by the SBV but not the Banking Association. This ceiling will

be adjusted flexibly to trends of inflation. At present, the ceiling is acceptably placed at around 12% and will be adjusted down once the inflation is curbed. The SBV is employing principal instruments of other countries such as OMO, discount rates, rediscount rates and required reserve so as to regulate the supply of money. In the event that the borrowing rate reaches its ceiling, SBV will inject money through these instruments with a view to reducing the borrowing rate. The lending rate will be based on agreement between two parties, get rid of the discrimination in which consumer loans pay agreed-upon interest rate while the lending rate on corporate loans is not allowed to exceed 150% of the base rate with the result that banks try to exploit all possible loopholes in regulations on the lending rate and SBV has to spend more time and energy investigating commercial banks. As for the base rate, it will be considered as an orientation index averaged by the lending rate of big banks and publicized by the end of day or week. For example, if Vietnamese banks' lending rate is ranging from 14 to 15 percents, it is deemed as the base rate of Vietnam, which will be used to deal with loan sharks. As for banks, they will not employ the base rate but the borrowing rate ceiling; and the lending rate will be determined by agreement with borrowers. Consequently, the lending rate cannot exceed 150% of the prime rate due to the fact that the banks, with the borrowing rate of 12%, will earn some profit with the lending rate of 15% without reaching 21%. However, it is absolutely infeasible at present in that the borrowing rate plus bonus have edged up by 12%, so they can not offer a lending rate of 12% and banks are forced to make any kinds of charge for loans.

The SBV had better renew the open market operations in order to insure that the interest rate market is supporting the business operations, and prevents competition based on borrowing rates from affecting the economic policies.

c. Flexible rate of exchange:

Fluctuations in the dollar price in comparison with other hard currencies and with the VND showed that under the effect of financial crisis, the dollar became weaker than other currencies. Whereas, compared with the VND, the dollar is always on the increase regardless of reverse effect on it. The increased exchange rate to the dollar entails rises in exchange rates to other currencies even though there was not any unfavorable information concerning the fluctuation in exchange rates. It profoundly affected the price of commodities, raw materials and imported machinery, worsening the inflation and economic recovery. At some points in 2009, the exchange rate of free market was much higher than that of the official one, facilitating the huge hoard of foreign exchange and cornering the forex market. One US dollar, on November 11 at noon, was converted into VND20.000, setting a new record price in the free market of 2009. On November 25, SBV was bound to adjust the interbank exchange rate up, i.e. one US dollar could be converted to VND17.961 instead of 17.034, edging the permitted difference between exchange rates down to 3% instead of 5%. This is also the second adjustment of the exchange rate of the SBV for 2009 since the rate had been increased from 3% to 5% in March.

This adjustment would shoot the domestic price up, escalating the inflation and exposing enterprises to hardships. In addition, the up-adjusted interest rate would exhaust the economy without

solving any problems.

Therefore, the point is that we need to employ a flexible exchange rate mechanism and promote the full convertibility of the VND in order to prevent the hoard of US dollars and soothe public opinions. The US dollar is no more a unique tool for international payments or a safe reserve. Instead, the Euro and several of other currencies are speaking their volumes, thus the SBV should attend to them prior to promulgating its policies on the exchange rate.

Moreover, in order to accomplish other targets like export ones, authorities must, besides adjustments of exchange rate to the dollar, directly support enterprises by taking various measures to help them beef up trade promotion, strategies, product quality, investment, technology and human resource. In essence, Vietnam must reduce the trade deficit so as to decrease the demand for forex. Accordingly, Vietnam may apply some measures such as technical barriers, banking operations, policies on support for domestic production, especially production of import substitutes, and campaigns to encourage Vietnamese nationals to use Vietnam's products; and prevent smuggling. Only if Vietnam does those could it solve the trade deficit and stabilize the exchange rate. It is necessary to exert a stricter control over, and attract flows of immigrant remittances after the USD/VND exchanged rate was adjusted up by VND603 per dollar on Feb. 11, 2010; and the issuance of quota for import of gold also helps facilitate the control of US dollars on out-of-bank markets. Finally, Vietnam needs to get rid of the exchange rate gap between banks and black markets in order to secure the interest of customers when selling US dollars to banks.

d. Enhancement of transparency and accountability:

The Government, SBV and other authorities of Vietnam must be aware of the significance of information regarding exchange rate, interest rate and monetary policy due to the fact that it may directly affect the belief of investors and citizens, the anticipated rate of inflation and investment decision as well. Thus, the transparency of information must be fully attended to. In addition, evaluation of performance in each stage must be undertaken in comparison with the approved plan, determining both achievements and non-achievements and building up the public trust in government's macroeconomic management and financial-monetary policies.

Moreover, banking and financial institutions must supply information about risks in financial statements and regularly publicize losses. Governing authorities must secure that these statements must generally, accurately and punctually depict the operation of organizations; and be rendered regularly■

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