

The realization of targets set for 1998 and reform in companies are facing difficulties. The economic development tends to slow down. The regional financial crisis spreading all over the world has forced the Government to adjust some targets with a view to keeping up the economic reform. In such a situation, fluctuations in the exchange rate to the

and demand in the market and to the regional economic situation has brought the official rate closer to the unofficial rate and put an end to unreal demand for and short supply of foreign exchange.

However, looking from the aspect of national interests, are the fluctuations in the exchange rate favorable for the economic development? What will happen to companies that

foreign exchange. The depreciation of regional currencies (baht, peso, ringgit, etc.) makes flows of goods coming into Vietnam increase, and causes the demand for foreign exchange to rise because many companies find that import is more profitable than export (while this depreciation makes Vietnamese export less competitive on foreign markets.)

+ Realities show that,

panies make timely decisions when trading in foreign exchange. However, looking from an overall aspect, this solution seem not to be reasonable and suitable to present economic conditions, because:

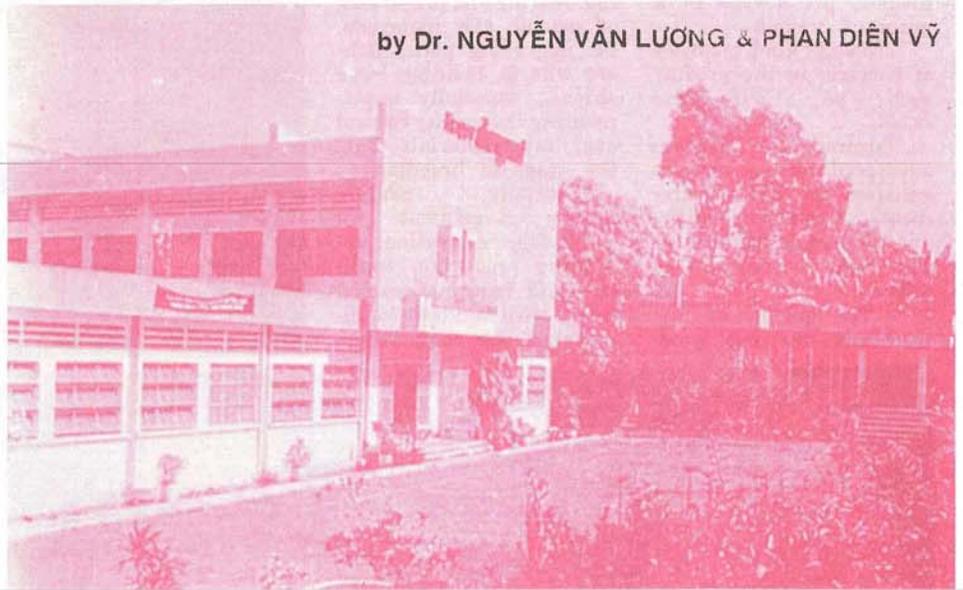
- The State Bank can't control the amount of foreign exchange traded in the market. Companies opening LCs under the deferred payment terms will suffer great losses

EXCHANGE RATE A WORRY FOR BANKS AND COMPANIES

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dollar have placed local companies in a dilemma.

It's worth noting that besides using macro-economic instruments, the Government has adopted many policies to regulate the economic development and make it suitable to the current situation. More exactly, in 1998, many Government Decisions (37/1998/QĐ-TTg on Feb. 14, 1998; 173/1998/QĐ-TTg on Sep. 12, 1998) and documents issued by the State Bank (Decision 342, Circular 08, Decision 319, etc.) helped companies to deal with the shortage of foreign exchange, accelerate positive changes in the socio-economic life and limit bad effects caused by the regional financial crisis. Efforts made by the State Bank to control the exchange rate by allowing it a fluctuation of 1%, and then of 5%, of 10%, and now 7%, have really helped the foreign-exchange market operate and fulfil its proper functions. The control over exchange rate according to conditions of supply



are badly in need of foreign exchange to pay to foreign partners? It requires discussions and studies to answer these questions. At present, however, the following difficulties are obvious:

+ In the current account of Vietnamese balance of payments, imports represent some 70% and exports 30%. That is why Vietnamese importers meet difficulties in purchasing

the need for many companies to settle due and overdue LCs has made the demand for foreign exchange exceed the supply at times, so fluctuations in the exchange rate become inevitable.

In such a situation, it's right to allow the exchange rate to change, upward or downward, by small increments over time, because this flexible exchange rate help com-

panies when the dollar rises against the domestic currency. If they become unable to repay foreign debt, they are on the brink of bankrupt, then commercial banks, acting as issuing banks, that are responsible for repaying debts stated in the LC, will meet with great difficulties in having their loans back, not to mention the fact that the issuing banks will have to supply more loans, even



in domestic currency, to companies if the LC under the deferred payment terms is changed into LC at sight.

- Until recently, the performance of commercial banks wasn't good. Percentage of overdue debts in these banks is alarming, especially when it is compared with the percentage suffered by Thailand's banks (15%) before they came to the financial crisis, and causing difficulties to commercial banks. In other words, all commercial banks are bearing debts for loss-making companies while their working capital comes from deposits made by people, not from the Government's grants-in-aid. So how long will credit subsidization and restructuring last and when will the Vietnamese banking system be able to compete against regional and international rivals?

-When imports represent 70% of the current account of the balance of payments, the Government must be cautious of devaluing the domestic currency because a wrong decision will limit the performance of the economy. It's worth noting that the control over exchange rate that aims at promoting export and limiting import is appropriate to the monetary stabilization policy.

But this doesn't mean that the Government should make the exchange rate be of service to export only and subjectively make adjustments to the exchange rate upon receiving signs (some of them are even false ones) from local and regional markets. Being flexible in regulating the exchange rate is a must but it should be based on a stable monetary policy and stable prices on the domestic market, instead of on the development of the regional financial crisis. Applying mechanically foreign solutions to local economy will be dangerous because we can't predict future consequences. Vietnam is developing a "socialism-oriented market economy under the state management", the control over exchange rate that aims at promoting export and limiting import is an effort to change the structure of industry. Therefore, export promotion must be based on a long-term strategy to change the structure of exports and encourage all economic sectors to develop. It's on this basis that the devaluation of the domestic currency can produce intended results. It will be dangerous to adjust the exchange rate with a view to promoting export overnight in this

period.

- At present, many people are worried by the possibility of a devaluation of the domestic currency, and they start to buy foreign exchange as they did 10 years before, making commercial banks meet with difficulties in attracting deposits.

- Some commercial banks are trying to buy foreign exchange in preparation for settling LCs and profiting from changes in the exchange rate. This activity also makes the demand for foreign exchange rise and signs from the market become inexact. Will the State Bank be able to regulate the exchange rate successfully or will it leave everything to the "invisible hand" if this situation lasts for a long time? At present, the State Bank is trying its best to stabilize the money market while some commercial banks are speculating in foreign exchange and foreign banks that hold big reserves in foreign exchange plus deposits in foreign exchange made by local commercial banks are taking control over the foreign exchange market. This situation makes it difficult for the Government to control the banking system. To save it, we think that the following measures should be

taken:

+ Taking control over flows of foreign exchange to and from commercial banks and flows of domestic currency to and from foreign banks; asking commercial banks to withdraw money from foreign banks and deposit it in State Bank branches; and supervise all transactions made by foreign banks.

+ Developing the foreign exchange market to control flows of exchange used for making payments to foreign parties.

+ Forcing all dealers and traders to accept the Vietnamese currency as the only legal tender in Vietnam as required by Decree 396/CP issued by the PM on Aug. 4, 1994 and Circular 12/QĐ -NH7 by the State Bank Governor on Sep. 5, 1994.

+ Requiring foreign banks and joint venture banks to make loans only in the domestic currency to local companies.

A breakthrough in controlling the exchange rate is very important to both commercial banks and companies and their relationship. It could also provide a basis for avoiding bad effects caused by the regional financial crisis to the national monetary policy and sustainable development of export. ■