DEMAND STIMULATION – CHEAP MONEY POLICY – SURPLUS AND SHORTAGE OF FUND

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The cheap money policy means increasing the money supply and negotiable instruments by lowering the lending and discount rates; reducing required reserve ratio and loosening conditions of a loan when the central bank refinances commercial banks and issues more bank notes to buy foreign exchange. In the past few years, the central bank has adopted a flexible monetary policy thereby ensuring an annual increase of 20-26% for the money supply, and of 22-28% for negotiable instruments.

These increases are high in comparison with other countries but they helped keep the growth rate high and inflation rate low for the past few years.

From 1998 on, the growth rate showed a downward tendency, the spending power reduced remarkably and there were gluts of many goods. To overcome these difficulties and stimulate the growth rate, many monetary measures should be taken to stimulate the market demand.

1. A cheap money policy

To stimulate the market demand, the central bank and Government have taken action to increase the money supply:

- From December 1997 on, the central bank has cut the lending rate ceiling many times: from 1.2% a month on short-term loan on Jan. 21,1998 to 1.1% after Feb. 1,1999; 1.15% after June, 1, 1999 and 1.05% after Aug. 1,1999; while the rate on medium and long term loans was reduced from 1.25% a month to 1.15%; and 1.05% during the same period. Commercial banks and other banking institutions also reduced their lending rate accordingly with a view to attracting more borrowers. The discount rate offered by the central bank to commercial banks was reduced from 1.1% a month on Jan. 21,1998 to 1.0% after Feb. 1,1999 and 0.85% after August 1999. Thus, the lending rate came to the lowest point in the last ten years and it is approaching the interest rate applied in neighboring countries.

- After July 5,1999, the required reserve ratio was reduced to 5% for 12-month deposits placed with commercial banks and finance companies, and to 1% for deposits placed with rural commercial banks, central and regional credit funds. Thus, the required reserve ratio was reduced by 3-4% as compared with the previous period.

- The Government and central bank also made decisions to loosen conditions of a loan. Decision 67/QĐ-TTg by the PM allowed rural commercial banks to supply fiduciary loans of VND10 million at max to farmers providing that they could produce a land use certificate. This is an effort to provide some four million farmers with necessary working capital.

- When the banking system tried to lower the lending rate, many local governments, in Hà Nội, HCMC, Quảng Trị and Sơn La for example, subsidized certain major projects and companies under their direction in order to help them cover the difference of 0.81% between the bank lending rate and the rate on preferred loan supplied by the Treasury. These subsidies varied from VND10 to over 100 billion over provinces. This measure helped banks increase their lending.

Until recently, the HCMC government has made plan to supply VND4,684 billion to infrastructure projects in order to cover the bank interest, either partly or totally.

Some plans to offer subsidies to companies purchasing farm products have also been submitted to the Government.

- The central bank injected a big amount of bank notes by purchasing foreign exchange from commercial banks. For example, the central bank has recently exchanged VND560 billion for some US$40 million from the Bank for Industry and Commerce.

The PM has recently issued Decision 118/QĐ-TTg allowing the central bank to supply US$400 million to certain national projects carried out according to the Government's work program.

Thus, we can see that the Government, central bank, ministries and local governments have tried their best to stimulate the market demand by various measures to increase the money supply. The problem, however, is how far the impact of these measures is.

2. Is there a shortage or surplus of fund?

In fact, the above-mentioned measures have been also taken by many Asian countries (Thailand, Singapore, Malaysia, Indonesia, Philippines and Japan) as a solution to the financial crisis. Many famous economists have even advised Japan to increase the money supply. So, what Vietnam is carrying out is appropriate to the common trend in neighboring countries.

In spite of these efforts which were considered as consistent, the situation witnessed almost no change. In the first half of 1999, the total loan and investment supplied by the banking system increased only by 6%, much lower than the planned target of 18% set for the year, while the total bank deposit increased by 9% against the planned target of 25% for the year.

Taking a closer look at the top four state-run commercial banks that control collectively a 70% market share, official data showed that the total outstanding loan supplied by the Bank for Investment and Development increased by 11% in the first half of 1999 against the planned target of 30%. This figure found in the Bank for Foreign Trade was 7.4% (target: 16-18%); in the Bank for Industry and Commerce was 9% (target: 18-20%) and in the Bank for Agriculture and Rural Development was 6% (target: 32-37%).

The increases in total credit supplied by commercial banks, branches of foreign banks and joint venture banks were also low in comparison with the same period in previous years and with their planned targets as well. Thus, the effort to inject more capital through the banking system didn't produce intended result regardless of many measures to carry the cheap money policy while the bank deposit kept on increasing.

When the measures to stimulate the market demand were put forward, many people were of the opinion that these measures were suitable because the economy was in recession, many consumers had no ability to buy goods and services, and there was a shortage of money supply.

Looking at increases in bank deposits in the first half of 1999, we had an impression that the reverse had happened: the bank deposit kept on rising when the deposit rate was cut to the bone, so it's difficult to say that there is a shortage of fund.

Over a year ago, all commercial banks and banking institutions have reduced the deposit rate and it is at the lowest level now. The interest rate on 6-month certificates of deposit is 0.8% a month, and on call deposits is 0.6-0.7%, however, the bank deposit in 1998 increased by 25% in comparison with 1997 (the increase was 31% in 1996 and 30% in 1997) while the total outstanding loan increased only by 19%. In the first half of 1999, the bank deposit rose by 9%, 1.5 times higher than the increase in the outstanding loan (6%). In most commercial banks, the increase in deposit was from 1.8 to 3 times higher than that in outstanding loan. In the Bank for Investment and Development the deposit rose 20% against an 11% increase in the outstanding loan; those figures in the Bank for Industry and Commerce were 15% against 7.4%. The Bank for Investment and Development could sell VND2,000 billion worth of medium- and long-term bonds within a short period and the National Treasury sold VND4,496 billion worth of government bonds within two months, commercial banks spent some VND2,550 billion on these bonds. To reduce the surplus of fund, commercial banks decided to invested some VND2,000 billion in T-bills, besides the government bonds, put out to tender by the National Treasury in the first half of 1999. The National Treasury also sold VND3,100 billion worth of T-bills to the public in the first four months of the year. Thus, the banking system and the National Treasury attracted a large volume of bank notes from the public in the first half of 1999.

3. Current effective demand

This situation posed two questions: Is there a shortage or a surplus of fund and how is the fall in spending power (or market demand)? The following analyses could provide us with some food for thought.

- There is a tendency to cut spending and make financial investment when the economy is in recession.

- Businesspersons don't want to make new investments when the economy remains in the doldrums.

- After suffering big bad debts owed by such companies as Tamexco, Minh Phụng and Epco, most banks are reluctant to supply fiduciary loans and always require mortgage instead.

- Most companies fail to work out profitable projects that could persuade banks into supplying loans. The narrowing market for Vietnam's exports also reduces the demand for capital. Many cement, sugar and building materials companies that are traditional customers of banks are suffering big gluts and have to stop borrowing from banks. Rural residents that could be seen as a big potential market for bank loan represent only 20% of the total outstanding loan because they couldn't find buyers for their produce. Finally, the banks themselves are reluctant to supply fiduciary loans for fear of an increase in bad debt.

The overall measures to the surplus of fund in banks are: promoting export and reducing import with a view to encouraging local production; helping local companies improve their competitiveness; increasing the government investment; lowering the lending rate and reducing the required reserve ratio■