

exhausts the foreign exchange reserve when the fall in value of the domestic currency is caused by the inflation.

b. In regulating the exchange rate, we shouldn't deal with the purchasing power only, because thinking through to adjust the exchange rate by decreasing the value of domestic currency when its purchasing power is on the decrease can lead to nothing but economic shocks, and more importantly, the vicious spiral of increasing inflation and decreasing exchange rate. In such cases, it's necessary to separate relatively these two variables from each other, and find out causes of inflation in order to curb it or reduce it effectively. After this was done, we can obtain a stable monetary system with an exchange rate which has been stabilized before. Any adjustment of the exchange rate based only on the purchasing power is nothing but a passive, temporary and unacceptable measure, because it goes against the nature of the exchange rate, and particularly, denies all other factors affecting the exchange rate in the market economy.

c. After adjusting the exchange rate, it's necessary to take measures to keep it stable and create favorable conditions for the foreign trade. The method of using exchange rate to encourage importation or exportation, as we must understand it, is very relative and limited, because, thinking through, there is no economic activity having an one-way meaning. The exportation, finally, aims at importation, therefore if an exchange rate favors exportation, it also discourages exporters when they want to import something. This relation must be sustained and set against a background of national monetary and finance policies.

The above-mentioned principles reflect main measures to stabilize the

exchange rate in long position and make adjustments to it in short position. This means that, the stability of the exchange rate becomes a red thread running through the process of manipulating monetary and finance policies as effectual instruments for achieving economic objectives.

Because the exchange rate has wide-ranging effects and great importance to the economy, all signs of simplification and subjectivity in handling and controlling the exchange rate will certainly lead to bad results. Human experience accumulated by taking part in international trade, especially in the market economy in the world and in Vietnam as well could provide us with a lot of examples of success and failure in dealing with the exchange rate. Fortunately, although Vietnam has just made a transition from the centrally planned economy to the market economy, but the way of handling and controlling the exchange rate in recent years has reflected abilities of monetary authorities to manipulate such an important instrument as the exchange rate and help to realize the national monetary policy.

However, facing such a complicated and abstract category as the exchange rate, nobody dare think that one has mastered and manipulated the exchange rate very well. The exchange rate as J.M. Keynes puts it, has two-sided effects: it is an effectual instrument for stabilizing the monetary system and the economy as a whole, but if we handle it incorrectly, it will become an obstacle to the economic stability. I think that this opinion is worth thinking about when we have to deal with the exchange rate every day. I hope that my above-mentioned opinions will help to find out the right way to approach this difficult and complicated economic category ■



## INFLATION OR DEFLATION - CAUSE AND HOW TO SETTLE

by Dr. NGUYỄN ĐẮC HƯNG

In August 1996, although natural calamity causes serious losses to the northern provinces but the prices of food, foodstuff saw no considerable change, the country's price index dropped by 0.4%. This is the third successive month from June until now with the fall in price index. So, the price index in the first eight months is only up by 2.2%, lower than ever and out of expectation. The prices proceeded like that and what is the inflation?

There can be different opinions on how to access the inflation rate, but in the past our inflation rate was regarded as consumer price index in the market. When I met Mr Micheal Bell, permanent representative of the International Monetary

Fund (IMF) in Vietnam, I asked him whether the way to figure out the inflation rate in Vietnam is different from the international practice or not. Although he said there was no difference in general, but he thought some prices were not included and our calculation is still different to some extend from regional countries. But anyway, the price fluctuation, or recent inflation trend caused the public anxiety, and different solutions to this problem as well, of which the solution of credit and foreign exchange rate is stressed.

In theory, there are causes of inflation, they are excessive money supply, demand pull and cost - push. Similarly, deflation is the shortage of money in circulation, production, and the

sales are stagnant...According to the definition of inflation by Samuelson and Saleman in the work "Economics", it is the common rise in prices. The dictionary of finance and banking (Peter Collin Publishing House - 1991), defines inflation as "Price hike leading to rise in production cost and thus the buying power of the money declines".

That shows when inflation occurs, there is interactive effect between three factors: price, production cost, buying power of money, or inflation is the sum of these factors, certainly there are main and subordinate ones.

From that definition, we will examine the reality of inflation of our country in the past. Firstly, it's the figure of 1995 which should be analyzed to see more clearly the situation of the past eight years.

In monetary field, the total mobilized capital of commercial banks increased by 37.5%, but the credit volume up by 23.4% only, total negotiable instruments up by 22.3% and total loans up by 27% from 1994. So, these indicators are suitable for the economic growth of 9.5% and inflation of 12.7%. The credit quality naturally declined, overdue debts rose, but the mobilized capital is bigger than total loans. That means a gigantic volume of idle money was attracted to banks and inflation was thus controlled.

As for the buying power of Vietnamese currency, in comparison with gold and US dollar, the prices of gold and US dollar dropped by 3% and 0.6% respectively. That shows the buying power of Vietnamese đồng is still on the "rise", certainly, it should be compared with prices of other commodities.

In examination of the price hike of commodities, firstly we see that rice price had the highest rise and rice took a lion's share in the volume of goods circulating in the market. Ob-

jectively, since natural calamity affected supply and demand, especially between areas. The world price of gold saw a little rise, Vietnam's rice exports price which increased much more than before has given impetus to rice export activity. Subjectively, the macro-economic management was not effective, especially for illegal export of rice via borders and the regulation of circulation between areas and periods.

Due to rise in food prices, foodstuff prices also went up. That originated from increasing costs of animal food in husbandry, and common increase in prices of agroproducts and foodstuff. At the same time, since the socio-economic situation changed, especially the population incomes increased, more and more foreigners entered Vietnam, so the demand for food rose, besides, food for export also increased.

Regarding building materials, the rise derived from booming demand and cement price skyrocketing which resulted from the poor management in production, circulation and export of Vietnam Cement Corporation, Ministry of Trade, Ministry of Construction, and Government Pricing Committee...In its turn, price hike of cement led to consequent rise in prices of other building materials.

As for the fluctuation of paper price, the important cause was the rise in production costs. From mid-1994, especially early 1994, early 1995, in the world market, prices of all paper and paper material increased by 30-80%, particularly notebook paper up from US\$650-700 to US\$1,150-1,220 per tonne, the price of eucalyptus wood (used for producing paper) in the domestic market also rose from VND270,000 to above VND300,000 per tonne. Meanwhile, the paper output could meet only two-third of domestic consumption, the rest must be im-

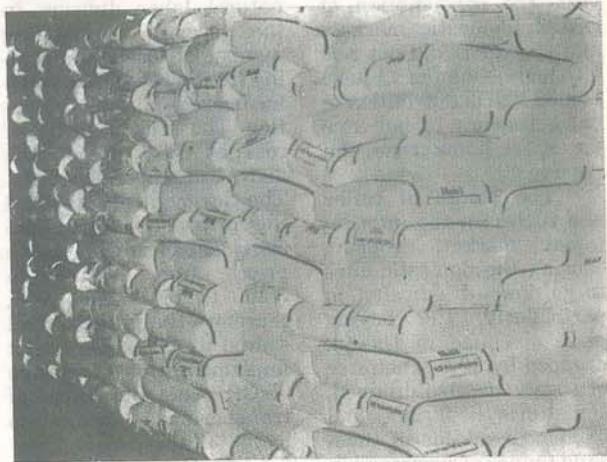
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The price fluctuation of such commodities as sugar, rubber, coffee, fabric...resulted from increases in the world prices, demand for export and consumption and the improvement of living standard.

In addition, the Government's adjustment of

on strict control over money circulation in order to limit the increase in the total negotiable instruments. Otherwise, the money factor is a first, permanent cause but the main one of high inflation is non-money factor.

According to the General Department of Statis-



prices of electricity, petrol, oil...lifted the production costs of many goods.

Examining the price fluctuation of these commodities, we see the causes of high rise (equivalent to the common CPI) in prices were cost-push, demand-pull and managerial shortcomings. These commodities were almost essential consumer goods. The people could put off buying television sets, motorcycles...but they could not stop spending on food, foodstuff or notebooks. We cannot blame the Central Bank's money supply for price booming of cement, food, foodstuff that exceed the common CPI.

Based on the inflation situation of 1995, we can affirm the main causes of inflation rate higher than expected are cost-push, demand-pull, including the ineffective management. The money supply is an important cause, which derived from the State budget. The Central Bank has implemented the policy

tics' figures, the inflation rate increased mainly in the first quarter (4.2% - January: 0.9%, February: 2.5%, March: 0.8%), especially before and after Tét festival, when the spending power soared. But the increase focussed only on some essential commodities, they are food, foodstuff and services. In February, the price of food jumped by 4.5%, foodstuff 4.2%, garments 1.4%, transportation means 1.2%, services 1.8% and gold 2.3%. That proves although in the first two months of this year the increase in prices was kept much lower than previous years, it was still in traditional upward trend due to booming sales in the New Lunar Year festival (Tét). The purchasing power derives from large payments to individuals, increasing incomes of population. It's a common sense, the requirements for cash and essential payments on Tét festival cannot be stopped due to inflationary worries. Generally speaking,

the food price has dropped from April, and the bottom was in August, by 6.8%, in Hà Nội alone by 8.8%. This has many causes, firstly due to the high unreasonable increase in the previous month, higher than the international price (above VND4,200 per kilogram of rice - US\$400 per tonne); secondly the farmers enjoyed successful harvest, the consumption of rice in domestic markets and for export did not rise although banks have lent VND3,000 billion to entrepreneurs to buy rice for export, home trade, and reserve.

The prices of coffee and rubber in the international market dropped, causing the domestic ones to go down drastically, in particular, the buying price of coffee in Daklak dropped by 30%. The price of sugarcane also dropped, sometimes the farmers had to keep hundreds of thousand tonnes of sugarcane in stock and suffered heavy losses.

Along with the fall in prices of the above commodities, the price of building materials also went down by 3.5%, cement price after a period of skyrocketing dropped continually and the domestic supply rose sharply due to large volume of exports, increasing domestic production, slowly rising consumption, sometimes the country stockpiled one million tonnes of cement and now 400,000 tonnes.

Regarding steel, its prices were both low and slowly consumed, that is the result of inaccurate forecast of demand and excessive import. So far, the whole country has stockpiled nearly 500,000 tonnes of building steel.

One of recent events is the stockpiling of paper with declining prices. The causes originates from excessive import, poor purchasing power, and seasonal consumption.

In addition, in the past eight months, prices of some commodities has un-

remarkable fluctuation, they are pharmaceuticals down by 0.3%, home appliances up by 0.1% and garments up by 2.0%.

Besides increase in some commodities, prices of some commodities saw upward trend, service prices rose by 5.7%, and 16% in Hà Nội and 6.7% in HCMC. This is suitable for the law due to economic growth, natural labor division in the society, increasing number of foreigners coming to Vietnam and high incomes of part of population. The price of foodstuff rose by 5.6% due to the above mentioned causes. The Government has lifted the price of water, especially petrol and kerosene prices from VND3,100-3,200 to VND3,700-4,000, therefore the prices of fuel soared by 6.9%. The strict implementation of Decree 36/CP made the prices of transportation means up by 3.3%.

As for monetary aspect, in the first six months of 1996, in accordance with the expectation of economic growth and inflation rate, the total loans of commercial banks soared by VND8,000 billion (15.7%) from 1995. Similarly, the mobilized capital of commercial banks also rose by VND8,000 billion (15.2%), meanwhile the total negotiable instruments also increased by 12.7%. So, the monetary problem is not worth much considering. Certainly, the glut of VND3,000 billion in commercial banks should be taken into consideration.

In short, the main causes of price fluctuation in the first eight months are as follows:

Domestic production still kept on increasing, legally or illegally imported goods, products assembled and made by jointventures were overwhelming. In the meantime, incomes of farmers, craftpersons and workers increased slowly and they also had to save for future. Although commercial banks have lowered interest rates many

times from the year's beginning until now, but the saving deposits still rose by VND10,000 billion. High income earners temporarily satisfy with demand for popular goods. So the purchasing power rises slowly.

The real estate market comes to stagnation, but the prices of land, house went down, the sellers were more than the buyers, the remaining capital amounted to some billion đồngs. The businesses of minihotels, renting houses, restaurants suffered losses and ran into big debts. That situation affected greatly the commodity market on the whole, especially building materials, equipment for internal decoration...

The Government's control over circulation, especially export was ineffective, caused many negative acts; the forecast was inaccurate and commercial banks expanded the guarantee of opening L/C for buying imports on deferred payment.

Domestic prices were directly affected by international ones, the Government's active adjustment of prices and the law of economic growth.

In Vietnam economy at present, food, foodstuff, petrol and building materials...are goods taking a lion's share in the volume of commodities circulating in the market. The fluctuation of these commodities made decisive impact on the common CPI. According to Vietnam current calculation of inflation rate, the process of inflation and deflation recently is easy to understand, and have the same trend in the coming time. But we also wondered why the foreign nations' inflation rates ranged between 1% and 3% although they had price booms of foreign exchange rate between US dollar, yen, Mark and other currencies, gold, rice, coffee, rubber, petrol, paper, metal...Their structure of commodities is certainly different from Vietnam's and so is their calcu-

lation. Vietnam's inflation rate brought out by foreign documents is also different from the figure announced by Vietnam, these figures in 1995, for example, were 17.5% and 12.7% respectively.

We cannot blame the Central Bank's money supply for the price booms of rice, cement, or sharp decrease in prices of paper, sugarcane...as well as declining price indexes in the last four months while thousands of billion đồng flowed into banks monthly.

Therefore, we should understand properly the reality of recent price fluctuation to take effective measures in the monetary area and avoid bad consequences. We have to accept their inevitable appearance, but soon rectify the deficiencies in circulation regulation, export management and loose conditions for opening L/C to import goods on deferred payment.

The method of calculating inflation rate should be made suitable. Money is not a main cause, but a permanent and important one. Therefore the Central Bank should abolish the credit line for commercial banks, resolutely settle violations of credit quality. The public and legal agencies should have proper view on banking activity in the current legal environment. Negative acts, tricks causing losses in loans must be soon settled.

Regarding the devaluation of Vietnamese đồng to promote export, Vietnam's capability of export depends on many factors, they are technological level, quality and design of products, commodity structure and category, export markets...not due to exchange rate. As a result, how can we devalue Vietnam currency while the foreign currency is abundant in reserve and businesses. Therefore we should make great money supply. At that time, what is the inflation and does the export boom? ■