TO PERFECT OPEN MARKET OPERATIONS IN VIETNAM

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1. General issues

Open market operations are activities by which the central bank engages in purchase and sale of securities in order to regulate the money supply and implement monetary policies. However, it is worth noting that the effectiveness of this instrument depends on its mechanism in connection with development of money and stock markets.

Views on the working of open market operations differ over countries. In some nations, these operations are limited to the money market, especially short-term securities while in others, they are extended into the stock market by which the central can trade in long- and medium -term securities whose maturity date is within a year. Realities of open market operations carried out by central banks in developed countries show that the larger scale of these operations helped a lot with the implementation of monetary policy, because:

- a wider variety of commodities makes markets busier.
- the central bank can affect the interest rate easier by engaging in the capital market (the market for long-term capital) than limiting itself to the money market (for short-term loans only).

However, in economies in transit where finance markets have just developed and their commodities aren't abundant and diverse enough, central banks face difficulties in making use of open market operations effectively, that is, effects of these operations are very limited.

2. Open market operations in Vietnam

When the two-level banking system was established in Vietnam, the SBV paid full attention to the open market operations. Article 33 of the State Bank of Vietnam Ordinance promulgated on July 24, 1994 reads: "The SBV is entitled to buy T-bills whose maturity date is within a year from banking institutions or sell them to these institutions." Article 21 of the State Bank of Vietnam Law also states: "The SBV carries out open market operations by buying and selling T-bills, deposit certificates, SBV bonds and other eligible papers on the money market in order to realize monetary policies."

Although the legal framework was provided, the open market operations have been just introduced to the primary market in form of loans supplied by the SBV to commercial banks. Up to July 2000, the open market actually came into operation, the SBV holds a trading session every 10 days to trade in T-bills and SBV bonds. In the past few months, however, these operations were still insignificant (the value of commodities traded in a session was some VND100 billion); and only three traders at most were present at each session while the membership is some 20. Causes of this situation are various, the main ones are as follows:

- Inefficient money market:

The SBV is only allowed to trade in short-term negotiable instruments while the money market only came into operation in 1994, therefore commodities aren't abundant. The market for T-bills is only a primary one and there is no secondary market. Generally, the money market needs a lot of new policies, good organization and facilities to operate well. In addition, the economic growth rate in the past five years was low and as a result, most banks suffered deposit surplus and they don't need selling bills or bonds.

- Lack of qualified securities:

At present, short-term negotiable instruments traded on the money market fail to meet standards set by Article 9, Point 4, of the State Bank of Vietnam Law (liquidity and great quantities outstanding). A look at these commodities reveals that:

- SBV bonds have high liquidity but they are issued at intervals when necessary, therefore the amount of SBV bonds isn't big.
- Trade papers aren't common among businesses although an ordinance about these papers was effective from July 1, 2000.

- Deposit certificates have no liquidity because they aren't allowed to be traded on the market.

- T-bills are saleable and have high liquidity but the market for them is limited. The Ministry of Finance in cooperation with the SBV has made only 9 issues of T-bills up to the end of 1999, because the Government only accepts budget deficit when it needs more money for investment projects. That is why T-bills aren't issued regularly and in large quantities (up to Nov. 15, 2000, only VND378.5 billion worth of T-bills were traded in comparison with VND1,444.5 billion worth of SBV bonds). On the other hand, government bonds that have the same liquidity as T-bills do are issued regularly and in large quantities on the stock market and are excluded from the open market operations.

In short, the main cause of poorly-developed open market operations is the fact that the principal commodities are limited to short-term negotiable instruments.

3. Measures to perfect open market operations

a. Diversifying commodities traded on the open market: Besides short-term negotiable instruments, the SBV could be allowed to trade in long -term ones, especially Treasury bonds and government's project bonds, on the following grounds:

- These bonds could be issued in large quantities and have high liquidity. Moreover, purchase and sale of such government securities by the SBV could help avoid clashes of interests usually caused by sale of company's shares.

- Trading in long-term securities makes the open market operations more popular and the SBV more active and flexible in carrying out monetary policies.

- Trading in long-term securities links the open market operations with stock market in generating capital for the economy.

These analyses show that the market for government's bond and bills of both short and long terms should be developed in parallel with development of stock and money markets. As for the SBV bonds, the SBV should expand the sale and purchase of them in order to become more active in carrying out the open market operations.

b. Liberalizing the trade in securities along with interest rates: The SBV could have its goods sold for cash and delivered immediately (spot market) or trade in futures contracts. It's worth noting that futures contracts can help the SBV carry out monetary policies more effectively. However, the trading on futures market requires more skills and experience of predicting the need for capital by the SBV and commercial banks as well. In addition, the SBV could use an auction system to sell government securities with a view to regulate directly the interest rate while the sale of Treasury bond and bills in fixed amounts is applied when the SBV wants to regulate free capital of commercial banks.

c. Combining other instruments to enhance efficiency of open market operations: The following measures could be taken:

- The SBV could increase the supply of loans in foreign exchange in order to diversify transactions of foreign exchange, make the foreign exchange market meet the demand and create favorable conditions for the development of open market operations. Chinese experience shows that the development of loans in foreign exchange by Chinese central bank since 1994 has made the money supply increase and forced the central bank to conduct more effective open market operations.

- Required reserve level could be reduced and kept stable in order to help commercial banks work out long-term business strategies.

d. Developing finance market: To develop the open market operations, the finance market with money and stock markets at its core, should function smoothly and actively to provide the economy with necessary capital. The development of finance market requires a well-organized system of supplying reliable information that could help attract more sellers and buyers to the open market.

However, at the first development stage of the finance market, the money market isn't combined with the stock market in supplying capital, the open market operations are only supporting instruments, besides interest rate and reserved requirement, for carrying out the monetary policies. We hope that the open market operations will develop in terms of size, kinds of commodities and transaction practices by 2010 and become useful instrument for the SBV to regulate the money supply and realize the monetary policies ■