CREDIT LINE AND INFLATION CONTROL

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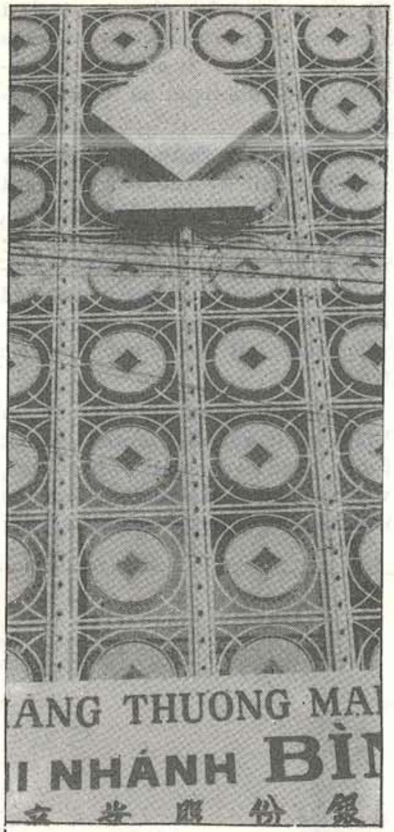
In order to control inflation and carry out the commitment to the International Monetary Fund (IMF), the Vietnam State Bank has used the credit line instrument in recent years. But there are different opinions and complaints about it in public, especially in Vietnam's enterprises and commercial banks. How can those complaints be explained and what is the basis of credit line?

According to economic theories, one of reasons for inflation is money, the increase in money volume in circulation leads to price hike. This is a very complicated problem, if money increases rapidly, commodities cannot rise proportionally, as a result this causes price skyrocketing. Therefore if the money can be directly controlled, then the inflation can be done the same. In the market economy, the central bank can control the volume of money and curb the inflation to some extent. To have effect on the money supply, the central bank has to control directly the assets of domestic and foreign currency (in the balance sheet of the central bank). In other words, as we know, the money supply has influence on prices, so we can control indirectly the assets of domestic and foreign currency in order to control the inflation. The asset of foreign currency can be difficultly controlled, but the central bank can control the asset of domestic currency easily.



In the content of domestic currency asset, there are credits firstly granted to the Government, secondly to commercial banks and other items. We need not pay attention to other items but have to pay attention to and can control credit items.

Credits granted to the Government have been well implemented in recent years. The central bank stopped granting loans to the State budget (stopped money issuance for the budget's expenditure). Therefore, to control prices successfully, we cannot control directly money, we have to control credits of commercial banks including credits for enterprises, organizations and individuals (production households as well). A scientific formula can not be applied to those kinds of credits, instead we have to well manage credits for enterprises, organizations and individuals. As a result, to control prices and inflation we have to depend upon the central bank's balance sheet with a view to controlling directly three above-mentioned credits.

As mentioned above, the relation between them cannot be determined exactly by a formula, so credit line is controlled sometimes strictly and sometimes loosely. To build the policy on credit line, the tight control over credit line must be initially done, this is better than the implementation first loose and later strict. The best is the first tight implementation which is gradually loosened. Therefore, this is one of reasons that there are complaints about credit line, since the Government and the Vietnam State Bank want to do strictly at first. The second reason is the credit line is applied uniformly to both good enterprises and bad ones. That is the IMF's recommendation to Vietnam.

In principle, enterprises are entitled to decide on loans with the market interest rates. Secondly, the central bank is permitted to manage the market interest rates through indirect tools. In Vietnam there are not these two conditions, since the interest rates are not determined by the market, there is not real competition in the market, the banking system is developed only at the first stage, enterprises do not operate completely in accordance with the market economy. Due to those reasons, the market competition cannot be fully depended upon.

To see whether the enterprise is worth receiving credits or not, we have to examine its financial capability. But the Vietnamese enterprises' accounting was not clear yet, the auditing has just been applied and difficult to trust in.

In the market economy, the central bank can rely on indirect tools and the market to manage interest rates and the monetary policy. But Vietnam has just changed into the market economy, so the central bank has to depend on the credit line. This is done in commitment to IMF.

But there are questions on how many countries in the world are carrying out credit line and among them how many countries are implementing their commitment to the IMF.

The number has not been exactly fixed yet, but it can be said that the countries come to the IMF from the two reasons: inflation and payment balance. They need aids to control inflation and overcome deficit in payment balance, Vietnam for example.

According to IMF, the finance market in Vietnam is underdeveloped, so the IMF has to produce measures of credit. In countries where the finance market is developed, they use indirect instruments, one of which is the central bank's rediscounting loans granted to commercial banks. If we see the IMF's programs offered to governments, there are about 80 programs on credit line and rediscounting loans, even rediscounting loans also has relation with credit line Many countries which did not receive IMF's programs also apply the credit line instrument such as Japan, Germany, the U.K... When their finance markets are developed, they change the aplication of credit line into the implementation of indirect tools. Otherwise, most of countries came to IMF, their governments and central banks applied credit line, they used it in the framework of IMF's programs since they did not have better tools.

However we can see that in reality according to the Banking Ordinance, the maximum obligatory reserve ratio amounts to 35%, so why don't we increase the obligatory reserve ratio to limit the credit amount.

Ideally speaking, any country having developed finance market and banking system can use other measures. Most of central banks in developed countries use rediscounting interest rate in order to control the credit volume of commercial banks. Centrally-planned countries want to fix interest rate whereas countries applying the market economy only produce indirect effect on interest rate.

We come back to the central bank's balance sheet, in the liability part including money in circulation and commercial banks' deposits in the central bank (money for obligatory reserve and securing payment). Its assets include credit for the Government, credit for commercial banks and other kinds of credit...

We have the following formula:

$M = K . RM$

In which: - M : money supply

- RM: obligatory reserve

- K: coefficient

In reality, it's hard to control M, so there should be impact on RM, (K is difficult to fix exactly, in Vietnam this coefficient is from 2 to 3). The problem is to have effect on the limit of reserve as well as on the credit.

In the market economy, the people's deposits in banks can be hardly controlled, that is Vietnam's difference today as compared with ten years ago. In the subsidized economy, the Vietnamese government wanted to directly control money. But in the market economy, indirect tools are used to control money whereas direct ones cannot be used.

Commercial banks' deposits in the central banks comprise two parts: firstly obligatory reserve representing 10-35% which can be controlled by the central bank, secondly commercial banks' deposits for securing payment, the central bank can hardly control these deposits. Just because of this, the Government and the central bank cannot depend completely upon these two kinds of deposits. It is explained that both of the two kinds of deposits represent about 20% of the total mobilized capital of the commercial bank, including 10% for reserve and 10% for securing payment. But in the total 10% money for securing payment, each bank has different ratio, for instance, Vietcombank can reach 20%, Bank for Agriculture 5%, commercial joint stock bank 0-3%. The trouble is in the 0-3% deposits of commercial joint stock banks. If the central bank increases the obligatory reserve to 20%, then Vietcombank can deduct 10% from payment securing funds, other banks cannot. Therefore this instrument cannot be applied, and others should be used to manage, so the reserve ratio cannot be raised from 10% to 35%. The second reason is deposit interest rate applied to commercial banks deposits for payment guarantee in the central bank is too low, only from 0 to 0.1%. As a matter of fact, in addition to using the lending interest rate of 1.75% per month to pay for deposits with interest rates of 0.7-1.4% per month, commercial banks have almost no more income. Therefore, commercial banks' profits will be reduced, so they cannot increase deposits for payment guarantee.

- The fixing of credit line make commercial banks be in surplus of capital, do not encourage them to attract capital from the people, this can influence the strategy for mobilizing capital with the aim to industrialize and modernize the country by the year 2000 and the attraction to idle money in circulation with a view to controlling inflation. Thanks to minute analyses, we can see in certain aspect credit line is not contrary to the strategy for capital mobilization for industrialization and modernization by the year 2000 since money only flows into banks when the economy is stabilized and the inflation is low. Contrarily, the people do not like to deposit their money in banks due to high inflation, this is Vietnamese lesson in the 1980s. Today in Vietnam, the inflation tends to go down, savings have upward trends. Although saving interest rate decreases, but the real interest rises. Therefore in Vietnam there is no way but implementation of credit line to curb inflation. In the long run when obtaining necessary and sufficient conditions, Vietnam has to get rid of credit line, the application of credit line is only the transitional measure.

Credit line and inflation control have close relation, but is the inflation figured out by Vietnam similar to the world and IMF? At present Vietnam considers consumer price index (CPI) as inflation rate. It is not basically different from the world's calculation, it is only difference in the method of figuring out. It was said whether there was other way apart from CPI to calculate inflation or not. Certainly there is not other way for calculation of inflation yet, but CPI does not include investment. CPI is used to find out inflation rate with a view to comparing it with GDP. Concerning GDP, deflation rate discovered after a year is out of date, as compared with the calculation. The 1995 deflation rate, for example, will be available in August-September 1996. They like to know the inflation rate per month. Therefore CPI is very useful and convenient. We return to the question whether CPI can measure the inflation in the economy or not. According to IMF, it attains little achievements in Vietnam, in other countries in the region, CPI also includes fluctuation of real estate prices. In Vietnam CPI do not reflect changes in immovable assets, house and office rents. In Vietnam the prices of house and land skyrocketed in the past but they dropped later and the CPI cannot measure them. In the eyes of economists, that is inflation, but not for Vietnam.

Credit line and inflation are complicated problems, to well settle their relation will make the economy develop. In Vietnam's current conditions, top priority should be given to the target of economic development, so the inflation in Vietnam should be reconsidered as either money or price inflation. Reality may show it is price inflation, thereby we can have proper solutions to credit line list with a view to speeding up the capital supply to the economy. ■