ON PRESENT INTEREST RATE

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In 1993, with the inflation rate of 5.2%, the real rate of interest became too high. Therefore by early 1994, the State Bank planned to lower interest rate. The problem remains to be solved is to choose the right moment for annoucement without creating social unrest. But in the first seven months of 1994, the inflation rate was 7.1% (1% a month on average), and controlling inflation became an urgent matter, so the lowering of interest rate was delayed, and the interest rate was still high as showed by following data:

Kind of deposit real rate of interest per year	1993	Calculated on average of first 7 months of 1994	Compared with 1993
Checking account (NOW account) 1.2%-5.2%=	-4%	-10.8%	-270%
Savings account (3 months) 16.8%-5.2% =	11.6%	4.8%	41%
3-month banker's bill 20.4%-5.2% =	15.2%	8.4%	55%
12-month banker's bill 26.4%-5.2% =	21.2%	14.4%	68%
Loan on highest interest 25.2%-5.2% =	20%	13.2%	66%
Loan on agreed highest interest 32.4%-5.2% =	27.2%	20.4%	75%

We can examine rates of interest in 1993 in some countries for comparison:

Country	Interest rate (*)		Interest of long bill	Consumer Price Index	Real Interest rate of (**)	
	of deposit	of loan			deposit	loan
Germany	7.4%	13.65%	6.97%	+4.3%	3.1%	9.35%
Canada	6.75%	7.46%	8.67%	+1.6%	5.15%	5.86%
USA	3.21%	6.0%	6.87%	+2.9%	0.31%	3.1%
Singapore	2.46%	5.55%		+2.2%	0.26%	3.25%
South Korea	10.0%	10..0%	13.2%	+5%	5%	5%
Thailand (***)	14.17%	19%	10.75%	+2.55%		

Source: *International Financial Statistics*, IMF, 1993
(*) using highest rate
(**) after taking away Consumer Price Index
(***) 1991 statistics

In comparison with real interest rate of said countries, interest rate of savings account in Vietnam in the same year was higher than that of any country (1.1 times compared with South Korea, 37 times with the USA), and interest rate of loan was 1.5 times higher than Germany, 4.2 times than the USA). This year, real interest rate in Vietnam is low because Consumer Price Index increased by 180% compared with last year. But the interest rate of deposit was reduced to 41% and the interest rate of loan was reduced to 75%. This can be seen clearly in difference between interest rate of deposit and loan in US$. Adding the inflation rate of US$ (1.3%) to these interest rates, the differences are as follows:

	Nominal rate of interest in US$	in VNĐ	Difference
3-month deposit	3.8% + 1.3% = 5.1%	16.8%	330%
12-month banker's bill	4.5% + 1.3% = 5.8%	26.4%	450%
Loan	7.25% + 1.3% = 8.55%	25.2%	290%
Loan on agreement		32.4%	380%

Basing on these analysis, we saw that present interest rate was very high. It can control inflation effectively but it also has bad effects on the economic growth rate. In other countries, it can cause depression.

One of arising problems is why it was accepted by market. Perhaps the answer lies in psychological aspect of both customers and banks. Being familiar to a high nominal rate of interest in the past, the customers took the present interest rate as a low rate because they didn't give attention to the inflation rate. The borrowers, especially businesspersons complained that the interest rate too high. As for the banks, especially joint stock banks, they are familiar to usurous rate of interest in marketplaces from the days they operated as credit cooperatives, they raised the interest rate continuously. Only a few banks kept regulated interest rate of loan. Some others started to reduce the rate of using capital, the borrowers are fewer but the interest rate of loan wasn't reduced. This showed that they were afraid that the inflation rate could go high this year.

Otherwise, the supply of money is less than the demand, because the people are impressed by a negative interest rate in the period of hyper-inflation, and because of uncared-for-tomorrow lifestyle. Just because of this lifestyle, there were only 6% of our population having savings account, and savings bank deposits per capita was only US$ 5 - 6. The banks paid only attention to current accounts which can bring in a profit and had no interest in large sum of idle money of the people.

In such a complicated situation, the best solution to the

problem of present interest rate isn't whether it could be reduced or not. The best solution not only controls the inflation effectively but also prevents the economic growth from bad effects, and protects the interest of both depositors and borrowers. In my opinion, such solution should comprise of following measures:

1. The interest rate of checking account should be raised in order to attract idle money and keep interest rate from becoming negative rate. It could be raised by 0.4% a month. This measure could prevent private businesses from opening savings account instead of checking account, and eliminate unfair competition between state and non-state banks, between state-owned agricultural banks whose borrowers (state agricultural businesses) are few and industrial-commercial banks whose borrowers (state industrial and commercial enterprises) are crowded.

2. The interest rate of savings account isn't changed in order to encourage personal savings, but this rate is applied only to personal savings, not to business capital. In other countries, income from savings account is taxed in order to keep savings deposit under a certain rate. In Vietnam, when we can't tax on income from savings account, we'd better keep savings account under VNĐ 100 million, because from VNĐ 100 million one can gain VNĐ 1.4 million a month which is over starting level of income imposed by tax. And naturally, an individual should be allowed to open only one savings account. This will be done easily with the help of computer. The interest rate of fixed deposit could be reduced to 1% a month. This is also a measure taken by many capitalist countries to prevent social division. It's absurd of us to orientate our economy towards socialism without applying this measure, because those who have VNĐ 1 billion in savings account could gain from VNĐ 14 to 16 million per month, 12 times higher than starting level of income imposed by tax.

3. The interest rate of loan should be reduced to 1.8% (21.6% per year) or 1.9% (22.8% per year) at most. Thus, the interest rate of deposit will be more than the interest rate of loan by 6 or 7% (whereas the difference between these rates in South Korea is 0%, Singapore 1.09%, Germany 6.25%). The reduced interest rate of loan will not be far away from the interest rate of loan in US$ (11.6% or 12.8% compared with 8.55%).

4. The interest rate of banker's bill should be reduced to 1.5% for 3-month bill and 1.7% for 12-month one. At the same time, the interest rate of loan on agreement should be reduced to 2.1% (25.2% per year). There's no need for a difference of 10.2% between those two kinds of bill at present.

5. The sales tax on banking business should be eliminated, because we can't reduce the interest rate of loan without doing it, and there's no such a tax in any country. This tax of 15% imposed on the difference between the interest rate of loan and of deposit has caused the interest rate of loan to go high. The present interest rate of deposit is 1.15% per month on average while the interest rate of loan is 2.4% per month, the difference is 1.25%. The sales tax of 15% on this difference has made the interest rate of loan increase by 0.19% per month (it is nearly equal to the interest rate of deposit in Singapore). This tax burdens the borrowers and slows down the economic growth rate.

In my opinion, Vietnam hasn't got enough conditions necessary for accepting a floating interest rate, we can only fix maxium rate of interest. These conditions are:

- A permanent inter-bank market and its volume of loans between the banks is large enough to control money market. For example, in France, the average of interest rates of 8 major banks was used as a basis for calculating PIBOR rate.
- The supply and demand of money should reflect the market need for capital. In Vietnam, the supply and demand of money are influenced by psychological state of the people.
- The people's habit of opening bank account and paying through banks.

Our reality showed that once the ceiling interest rate was fixed and the banks were allowed to choose various rates of interest, there is no alteration in interest rates of these banks.

The interest rate always has a strong influence on the economy. The fall of the system of credit cooperatives in 1990 because of sky-high interest rates is a precious lesson to us to pay attention not only to the capability of controlling inflation of the interest rate ♣