

VIETNAM

Exchange rate management

LECTURER: DR. Michel Henry BOUCHET

GROUP 3

CHU THI KIM OANH
NGUYEN LAP QUOC
TRAN MANH QUYNH



International finance

Agenda

Introduction

Exchange rate mechanism

Goals of exchange rate policy

Exchange Rates Policies of East Asia

Effects on Vietnam's competitiveness

Recommendation

Introduction

- Adequate exchange rate systems for developing countries takes a new turn. Most of the countries use the opportunity of a low valuation of their currencies and the swing from current account deficit to surplus to unilaterally fix their exchange rate or – at least – to frequently intervene in the currency market to avoid the rapid return of their currencies to pre-crisis levels
- The use of the exchange rate as a powerful tool of economic policy is often strictly limited by the influence that the global capital market and the policy of other countries apply on that rate
- Policy makers in developing countries, the fact that exchange rate movements directly influence the overall competitiveness of a country and have the potential to directly improve the overall trade performance of the majority of their firms and the balance of payments is a promising prospect

Introduction

- Developing and emerging-market economies in all the major regions have had to struggle with financial crises or their corruption effects once they have tried to manage the exchange rate unilaterally or even opted for free floating
- Long-lasting currency undervaluation can be extremely helpful to fully collect the benefits of open markets. A strategy to avoid overvaluation by any means has become the preferred tool of many governments and central banks
- In a world without a multilateral solution to the currency problem, the only way out for high-inflation or high-growth countries that are not members of a regional monetary union is to resort to controls of short-term capital flows or to follow a strategy of undervaluation and unilateral fixing

Exchange rate mechanism

- *Before March 1989: A multiple exchange rate system (with three-tier exchange rate system), fixed exchange rate policy*
 - High trade deficit
 - The large difference in the official and parallel exchange rate
- caused problems for the government budget promoted illegal activities in the black market*

Exchange rate arrangements

- *Mar 1989 - Feb 1999: VND has been pegged to the USD with several discrete realignments.*
 - SBV kept the VND/USD exchange rate at around 11,000 for more than five years from late 1991 to early 1997
 - From the summer of 1996, commercial banks were allowed to set exchange rates within a band of 5%
 - The exchange rate band was further broadened to $\pm 5\%$ in February 1997 and to $\pm 10\%$ in October 1997
 - In February 1998, the official central rate itself was devalued from 11,175 to 11,800 VND/USD

Exchange rate arrangements

- *From Feb 1999: ER system was reclassified as a crawling peg*
 - The central rate was now set daily at the average of interbank exchange rates on the previous transaction day with a very narrow band of $\pm 0.1\%$
 - With this mechanism, VND started to crawl (depreciate) very slowly around 15,000 – 16,000 in many years
- it is merely a technical procedure without analytical linkage with economic fundamentals*

Exchange rate band

Year	Band
1999 - Feb	+/- 0.1%
2002 - July	+/- 0.25%
2007 - Jan	+/- 0.5%
2007 - Dec	+/- 0.75%
2008 - Mar	+/- 1%
2008 - June	+/- 2%
2008 - Nov	+/- 3%
2009 - March	+/- 5%

Goals of exchange rate policy

- (1) Competitiveness
- (2) Price stability (X and M)
- (3) Current account adjustment
- (4) Domestic financial stability (balance-sheet problem)
- (5) Public debt management (exchange risks and debt sustainability)
- (6) Prevention of currency crisis
- (7) Minimizing the impact of various external shocks
- (8) Promoting growth, FDI and industrialization

Exchange rate policies

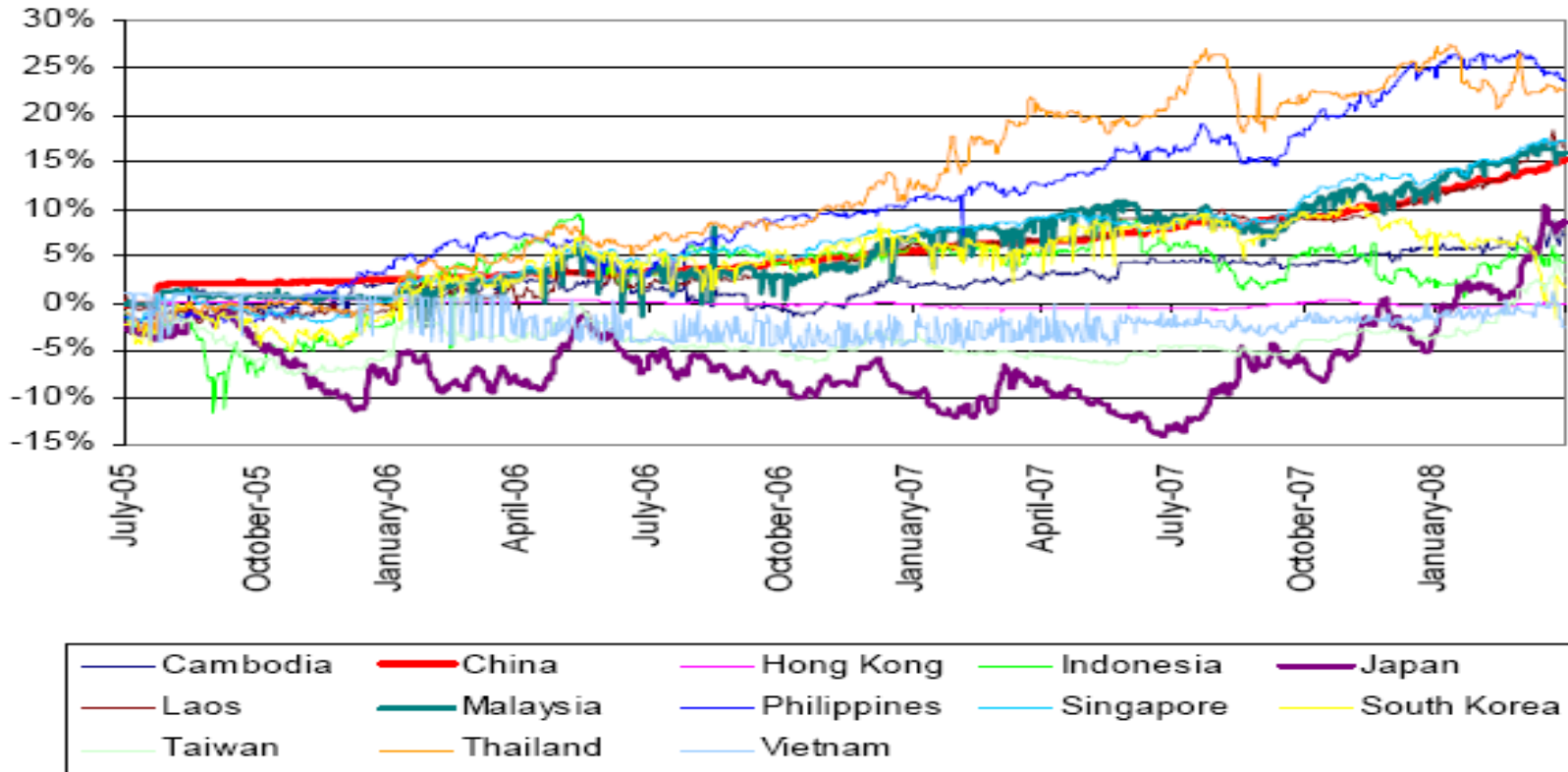
Exchange Rates Policies of East Asia

Economy Exchange	Rate Policy	Economy Exchange	Rate Policy
Cambodia	Managed Float	Philippines	Free Float
China	Crawling Peg	Singapore	Managed Float
Indonesia	Managed Float	South Korea	Free Float
Japan	Free Float	Taiwan	Managed Float
Laos	Managed Float	Thailand	Managed Float
Malaysia	Managed Float	Vietnam	Crawling Peg*

Source: IMF [<http://www.imf.org/external/np/mfd/er/2006/eng/0706.htm>].

Exchange rate arrangements

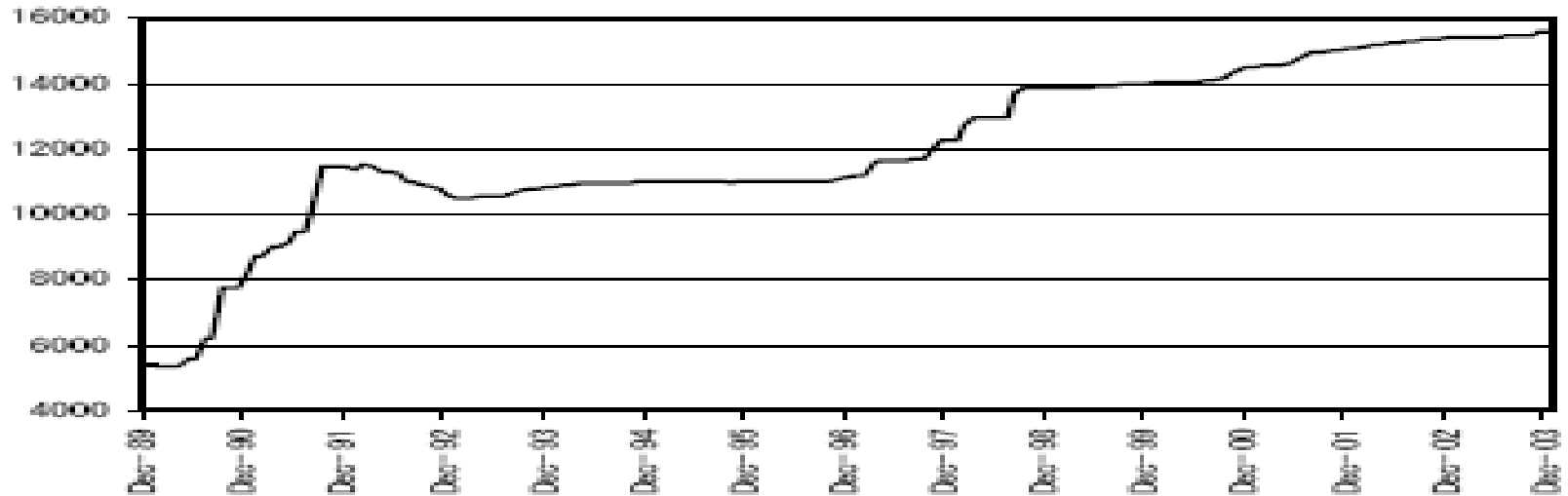
Figure 1. Changes in U.S. Dollar Exchange Rates for East Asian Currencies, July 2005 - February 2008
(base value = June 2005)



Source: CRS calculations based on publicly available daily exchange rate data

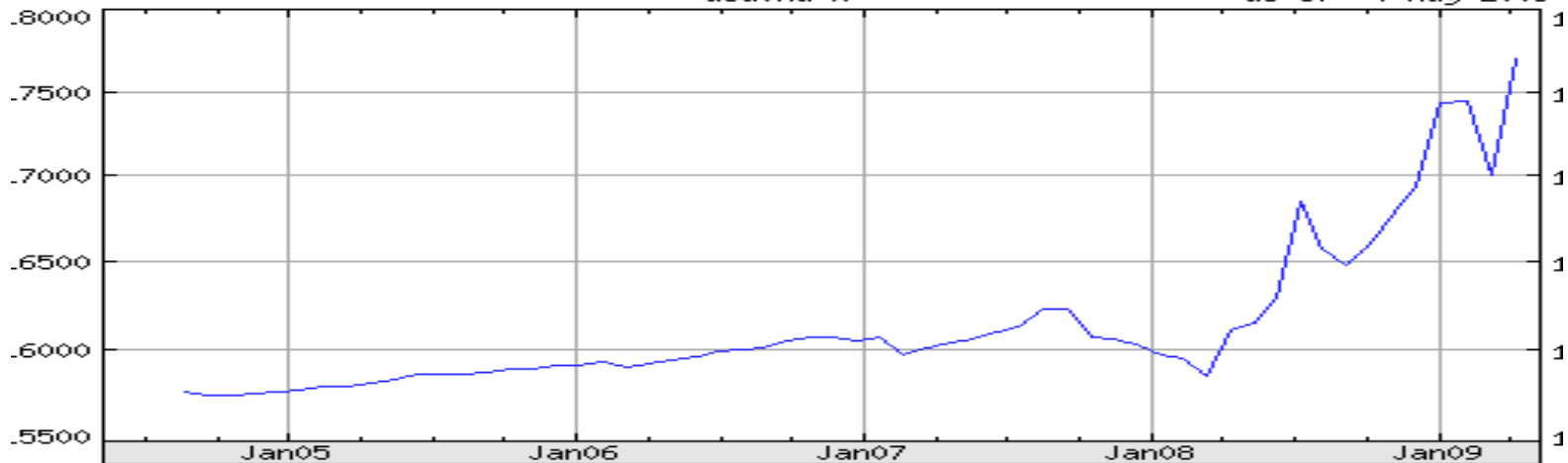
Exchange rate arrangements

VND/USD Exchange Rate



usdvnd=x

as of 4-May-2009

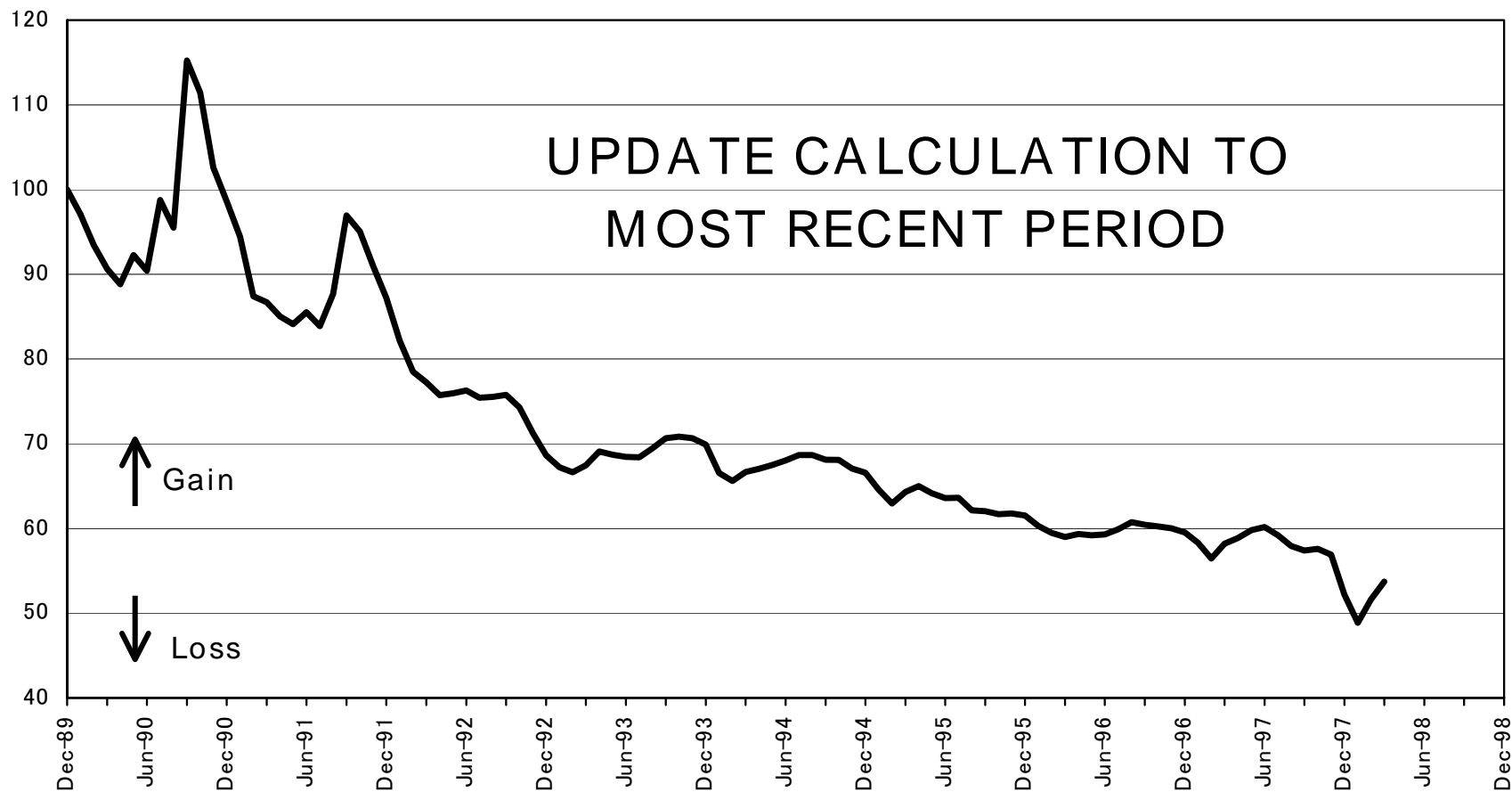


Effects on Vietnam's Competitiveness

- The exchange rate is not the key variable affecting Vietnam's competitiveness today.
- Instead, major trade agreements (e.g., USBTA, AFTA and potentially WTO) are having a larger net impact
- So what other policies can Vietnam pursue to sustain its competitiveness?

Effects on Vietnam's Competitiveness

Vietnam's Competitiveness
(Real effective exchange rate, Dec.1989 = 100)



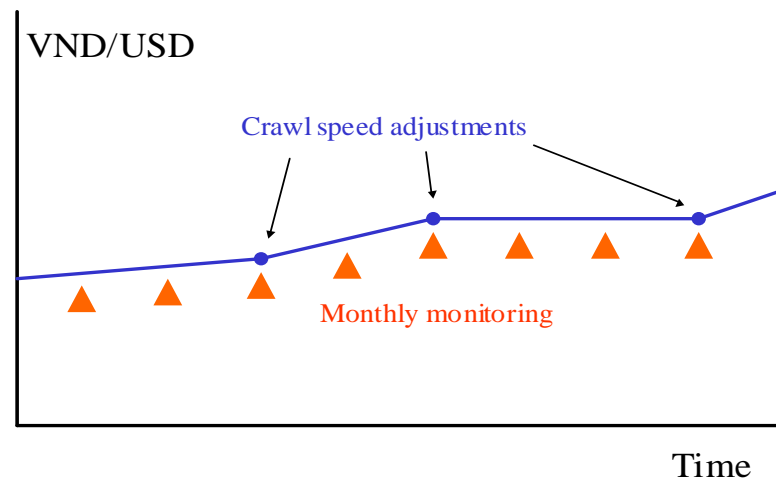
Recommendation

- Calculate “Real Effective Exchange Rate” regularly for policy input.
- Also systematically monitor a large number of economic variables including:
 - growth, prices, money, budget, trade & BOP, forex market, FDI & investment, banks, business conditions, asset markets, etc.
- Use judgment and information above to make a policy decision.
- Conduct research on measuring competitiveness, pass-through, global & regional trends, etc.

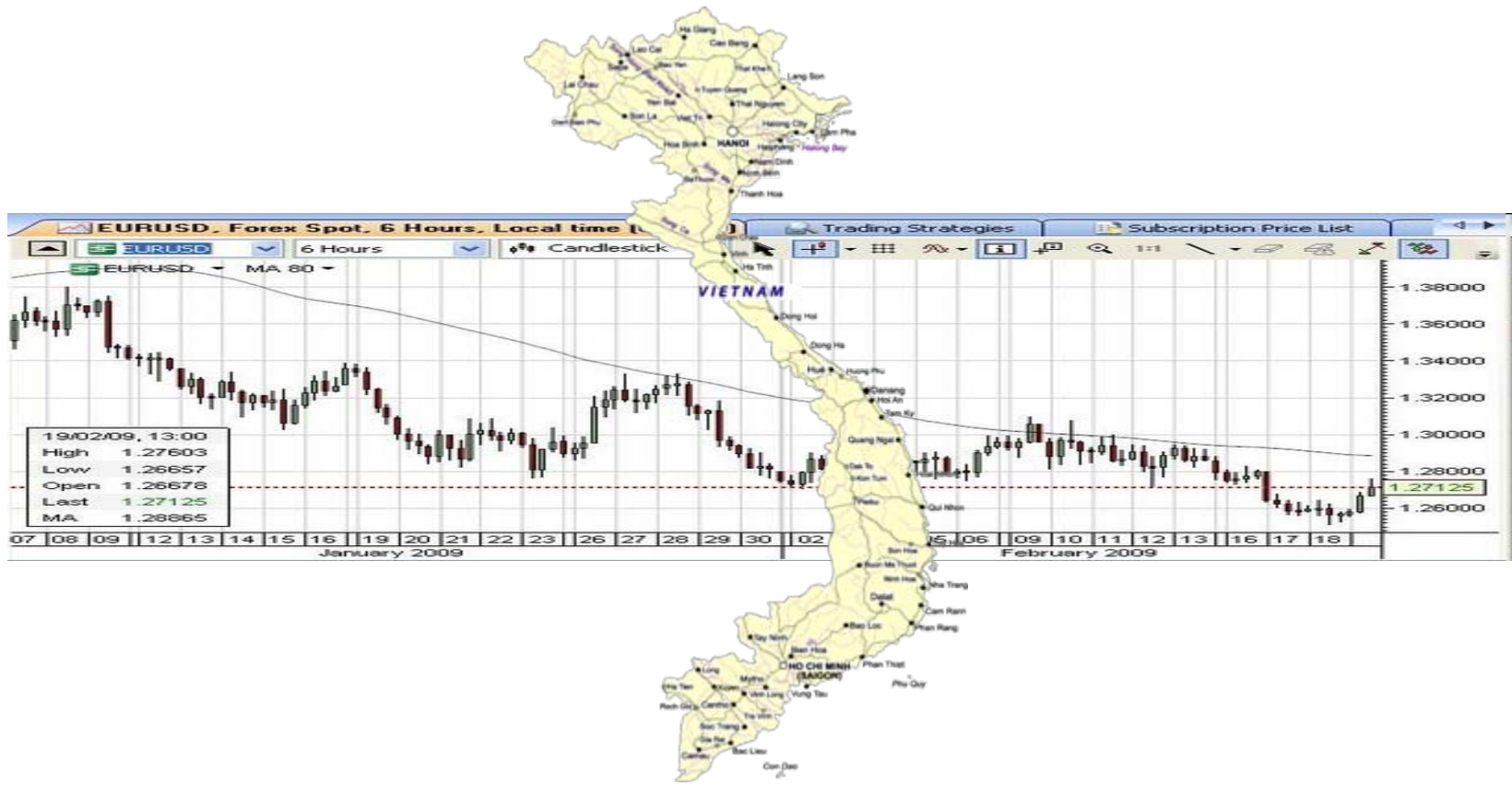
Recommendation

- SBV mainly sets the rate, while market force is used as a supplementary input. (VN's financial markets are still primitive.)
- SBV monitors the situation monthly and adjusts the crawling speed if necessary.
- The actual movement may not be very different from today, but SBV assumes more accountability based on proper analysis.

Variable Crawl with Monthly Evaluation



Thank you!



May 2009