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VIETNAM: THE ROAD TO INTEREST RATE LIBERALIZATION

I. THE FINANCIAL SECTOR AND INTEREST RATE POLICY BEFORE THE 2002 LIBERALIZATION

1. From a monobank system to the first round of liberalization

In Vietnam, under the central planning system, all formal financial transactions were undertaken exclusively through the State Bank of Vietnam (SBV). Before 1988, the Vietnamese banking system consisted of a 'monobank,' with the State Bank functioning both as a commercial bank and as a central bank. In addition, the State also owned and controlled directly two specialized banks, the Bank for Foreign Trade of Vietnam (Vietcombank, or VCB) and the Bank for Investment and Development of Vietnam (BIDV). VCB financed foreign trade activities and governed foreign exchange in addition to supporting state-owned enterprises (SOEs), while BIDV provided long-term capital to infrastructure projects and public works. The banking system was a tool to implement the government's policies, to meet fiscal needs and to meet the financial needs of SOEs. Directed credit at low nominal interest rates combined with high inflation created negative real interest rates. Furthermore, lending rates were even lower than deposit rates, reflecting the government policy of supplying credit subsidies (Table 1).

The year 1988 saw the first major reform in the Vietnamese financial and banking system. Decree No. 53/HDBT dated March 26, 1988 issued by the Council of Ministers triggered a shake-up of banking with three important reforms:

- the fiscal management function was separated from the SBV to form the State Treasury system;
- the commercial function was taken out from the SBV and assigned to the specialized banks;
- two more specialized banks were formed: the Industrial and Commercial Bank of Vietnam (ICB), and the Bank for Agricultural Development of Vietnam (later renamed the Vietnam Bank for Agriculture and Rural Development). These banks, together with the two previous banks, Vietcombank and BIDV, functioned as commercial banks.

The four specialized banks operated exclusively in their own fields until this restriction was abolished and non state-owned commercial banks were formed following the promulgation of the Law on the State Bank and the Law on Credit Institutions in 1990.

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English translation by Kim Chi.

Lending rates and deposit rates offered by the state-owned commercial banks (SOCBs) were set by the SBV. In accordance with the SBV's regulations, commercial banks also charged different lending rates on loans for agriculture, industry and commerce (see Table 1). The variation in lending rates reflected the relative investment priority accorded to each sector, rather than the project-specific risk.

Table 1. Interest rates, 1989-94 (percent per month, end of period)

	1989	1990	1991	1992	1993	1994
Demand deposit rate (individuals)	5.0	2.4	2.1	1.0	0.7	0.7
3-month deposit rate (individuals and firms)	7.0	4.0	3.5	2.0	1.4	1.4
Lending rates						
Agriculture	3.7	2.4	3.3	2.5	…	…
Industry & freight transport	3.8	2.7	3.0	2.0	…	…
Trading & tourism	3.9	2.9	3.7	2.7	…	…
Fixed capital	…	0.8	0.8	1.8	1.2	1.7
Working capital	…	…	…	2.7	2.1	2.1
Interest rate spread	-3.3	-1.3	-0.5	0.5	0.7	…
Inflation	2.7	7.7	4.8	1.1	1.2	0.9
Real interest rates						
3-month savings deposits (individuals)	4.3	-3.7	-1.3	0.9	0.2	…
Industry & freight transport	1.1	-5.0	-1.8	0.9	…	…

Source: World Bank, *Vietnam Financial Sector Review*, 1995.

The year 1988 also saw the first attempt at financial liberalization in Vietnam with the Decision of the Council of Ministers dated March 9, 1988 allowing all business organizations, including the private sector, to borrow and raise funds publicly. There are three points worth noting here. Firstly, the country was under conditions of unprecedented macroeconomic instability during the period 1986-1988. With the government printing money to finance the fiscal deficit, three-digit hyperinflation existed throughout these three years. Secondly, financial liberalization was undertaken at a time when there were almost no reforms of the manufacturing sector, SOEs, or foreign trade activities. In fact, only the agricultural sector was liberalized, and many prices were still seriously distorted. Thirdly, liberalization went so far as to allow all business organizations to trade currencies at a time when there was no financial regulation system in existence. Institutions raising funds publicly in the form of saving deposits did not have to comply with traditional banking regulations, such as the reserve requirement or the capital to loan ratio.

Credit cooperatives and credit funds were growing rapidly during this time. From the first one founded in the south in 1983, the total number of credit cooperatives and credit funds increased to 7,180 by the end of the 1980s (Vuong Nhat Huong et al. [2002]). A considerable number of the urban credit cooperatives increased borrowing rates in the competition for deposits. The whole system fell into a spiral of adverse selection and moral hazard. Initially, only some credit cooperatives offered high deposit rates to attract depositors. However, the others came under competitive pressure and were forced to increase their deposit rates as well. This is a typical example of adverse selection. At the same time, the absence of regulations on capital adequacy led to moral hazard. It is rational for profit maximizing entities to invest in risky projects with possible high returns, and then use part of the returns to pay back the borrowed funds where the credit funds are not subject to the regulations on capital adequacy. If the investments are successful, the returns will be more than enough to make interest payments plus a large residual profit. If the investments fail, not much will be lost, since the initial equity capital is negligible.

In the absence of regulation and supervision, the pursuit of profit by the credit funds and cooperatives (followed by businesses) through borrowing money at high interest rates, quickly led to fraudulent behavior. An example was the Thanh Huong Perfume Firm in 1990. An investigation after the firm had collapsed suggests that this was a financial pyramid/ponzi scheme fraud of the type seen in virtually all financial systems in the world. What Thanh Huong had done was to raise funds publicly at a nominal interest rate of up to 12% per month. How was the firm able to afford to pay such a high rate? The answer was through deposits. That is, interest payments to previous depositors were made using the later savers' deposits. The fact that the firm paid interest smoothly increased its creditworthiness, and hence, attracted more depositors. As in other places, the saving and loan institutions based on the pyramid scheme model collapsed with tens of thousands of people losing their savings. Following Thanh Huong, a series of other urban credit funds and cooperatives went bankrupt, creating the most systematic credit collapse ever in Vietnam. In addition to the above, macroeconomic imbalances were also a contributing factor to the credit collapses. Inflation though reducing still ran at 70-80% per year. Thus, financial institutions were not able to appraise projects based on market conditions, although there were no interest rate controls.

At the end of 1990, the total number of Credit Cooperatives and Credit Funds was only 160. Besides the money losses, the 1990 credit crisis also generated a loss of people's confidence in the banking system. Some research suggests that the loss of confidence together with negative real interest rates then induced many people to withdraw their savings and shift to gold or the US dollar (see part 4 on dollarization). The financial depth (measured by the M3/GDP ratio) reduced to 24.6% in 1992 from 27.8% in 1989 (World Bank, 1994).

2. The banking system, the interest rate ceiling and monetary policy management tools from 1994 to 1997

After the laws, decrees and directives regulating credit institutions' operations had been passed, joint-stock commercial banks (JSBs), joint-venture banks, and foreign bank branches were established and began to provide financial services. The SOCBs began to shift from directed or policy lending towards commercial lending. Table 2 shows the banking structure of Vietnam at the end of 1994 and 1998. Despite the existence of many non-state banks, the SOCBs still dominated: their share of total bank assets reduced only slightly, from 89% in 1994 to 82% in 1998.

Table 2. Vietnam: Composition of Banking System Accepting Deposits, 1994 and 1998

Commercial Bank	1994		1998	
	Proportion of total assets (%)	Number of banks	Proportion of total assets (%)	Number of banks
State-owned banks	89	4	82	4
Vietcombank	33		22	
Bank for Agr. & Rural Development	20		19	
Bank for Investment & Development	16		22	
Commercial & Industrial Bank	21		19	
Other banks	11		18	
Joint-stock banks	…	46	10	51
Joint-venture banks	…	3	8	4
Foreign bank branches	…	13		23

Source: World Bank, *Vietnam Financial Sector Review*, World Bank Country Report, 1995; and IMF, *Vietnam Selected Issues*, IMF Staff Country Report No 99/55, 7/1999.

In response to the credit collapses, the SBV imposed banking regulations, granted more autonomy to the SOCBs, and enhanced bank supervision. Inflation reduced and came under control as the fiscal deficit was no longer financed by printing money. In theory, the SBV could deploy a lot of monetary policy tools such as interest rates, credit ceilings, reserve requirements, recapitalization, and Treasury Bill auction (see Box 1). In practice, however, the money supply was controlled mainly by the credit ceiling imposed for every commercial bank from 1994. In other words, the SBV controlled the money supply under a direct mechanism rather than using indirect monetary policy tools like many other market economies.

In fact, indirect tools did not work well under the financial conditions existing in Vietnam at that time. Interest rates were an indispensable component of a depressed financial system, rather than a tool to control the money supply. From 1990, the SBV imposed a ceiling on lending rates for both domestic and foreign currency loans, discriminating by sectors. That is, different ceilings were applied to loans for agriculture, industry, and trading and services. Different deposit rates were set for households and firms as well.

Box 1. Monetary tools in Vietnam, 1994-1998

Credit ceilings

From 1994, the SBV began to impose a certain credit ceiling for each bank to maintain credit targets and growth of the money supply. The ceilings were initially applied for SOCBs only, and then expanded to other banks. The criteria on which the ceiling for each bank was based were not announced. In 1996, the government issued a Decision allowing banks to trade their credit ceilings. However, such transactions were not actually made until 1998.

The required reserve ratio

From 1995, a required reserve ratio of 10% was applied for all banks (except the People's Credit Funds, rural joint-stock banks, and Credit Cooperatives), on all kinds of deposits (except domestic currency deposits of more than 1 year maturity).

Recapitalization

The SBV recapitalized the SOCBs by loaning to these banks with tradable debentures or promissory notes used as collateral. The interest rates on recapitalized loans were unified in 1994. The SOCBs were also provided with short-term recapitalized loans to meet the need for liquidity in their clearing activities.

Treasury Bill Auction

Since the middle of 1995, Treasury bills have been issued on the market to make tenders based on interest rates offered mainly by commercial banks. These bills have been largely bought by SOCBs. Other Treasury notes and bonds have been sold to non-bank sectors as well.

Interest rates

The real deposit rates for individuals and the real lending rates on both working capital and fixed capital loans have been consistently positive during the reform period; and the real deposit rates for businesses have been positive since 1995. The revenue tax for banks was abolished in 1995, but replaced by a maximum limit on net interest earnings (i.e. a limit on interest spread) at 0.35% per month. The ceiling on short-term loan rates was 1% per month in 1998.

Source: Extracted from Box I.2. in *Vietnam: Selected Issues and Statistical Appendix*, IMF Staff Country Report No 98/30, 4/1998.

However, interest rate policy management has been significantly improved over time. Nominal interest rates have been linked to the price index to ensure positive real interest rates since 1992. Table 1 also shows that lending rates have been higher than deposit rates since 1992; this is a requisite for banks' normal operations. In 1993, the discrimination in lending rates between sectors was abolished, but lending rates still varied across working capital loans and fixed capital loans. However, the lending rates on fixed capital loans were lower than on working capital loans, creating an improper, reversed structure of interest rates. That is, the long-term lending rates were lower than the short-term rates. This policy discouraged banks from making long term loans. The short-term lending rates didn't fall below the medium and long term lending rates until 1996.

The SBV continuously maintained a ceiling on lending rates. From 1995, the SBV allowed commercial banks to set deposit rates themselves to enhance competition in raising funds. However, the maximum spread between lending rates and deposit rates allowed was 0.35% per month. In a sense, banks were subject to both lending and deposit rate ceilings, although the actual spreads might be different across the banks depending on their own expenses. This policy helped banks in maintaining a profit margin, but it was not in the depositors' interest. The World Bank (1995) argues that it was the reason for the slow growth of bank deposits and the high cash-to-money supply ratio.[1]

The primary reason for keeping interest rate ceilings was to restrict adverse selection, or prevent the banks from over-increasing deposit rates, and then using the funds raised in risky lending, as happened in the 1990 credit collapse. However, the interest rate ceiling policy, together with the directed credit allocation, was an indispensable component of the depressed financial system in Vietnam (at least in the early 1990s) to ensure that targeted sectors would receive funds at reasonable prices. This can be seen from the fact that banks could raise funds and lend at higher-than-ceiling rates for purpose-linked mobilized funds. That is, banks could raise funds at a rate higher than the deposit rate ceiling, and then lend all these funds at a rate higher than the lending rate ceiling for specific projects. If preventing adverse selection was the main reason for imposing interest rate ceilings, then the purpose-linked mobilized funds would never be allowed.

The Nineties also witnessed an effort to develop the interbank money market. This market was established in 1993. The aim was to enable the SBV to use it to set interest rates. However, inter-bank transactions did not increase regularly due to a lack of trust between the banks (Box 2). The money market, dealing mainly in Treasury bills, started to develop. As in other attempts to develop markets, the tenders on Treasury Bills did not make interest rates reflect market signals, since the government set a directed interest rate (i.e. an interest rate ceiling) for every tender.

Box 2. The inter-bank money market

The inter-bank money market started operation in 1993, but has not fully developed yet due to the small amount of intermediary funds, the lack of a settlement/clearing system covering the whole country, and the administrative regulations on interest rates. Most of the inter-bank transactions have involved the SBV's financing SOCBs with high levels of non-returnable loans and low capital-asset ratios. The inter-bank market has been little used as an intermediary for capitalization between banks. These problems are stifling the market's capability to draw short-term funds into the financial system and to reduce risk efficiently.

The interbank market is organized and regulated by the SBV. It has 40 members, including SOCBs, JSBs, and foreign bank branches. The SBV announced that it would guarantee transactions between JSBs and/or foreign bank branches, but it would not be technically responsible for settlements.

[1] In the early 1990s, the cash growth rate was higher than the bank deposit growth rate. Hence, the cash-to-money supply (M3) ratio in Vietnam increased from 31.7% in 1989 to a peak of 43.3% in 1994. The cash-to-money supply ratio has reduced since 1995, and was 23% in 2001. The equivalent ratios were 11.2% and 9.5% in 2001 for China and Thailand, respectively.

In fact, the inter-bank market is a centralized market. Inter-bank transactions are made bilaterally and regulated by the SBV. Parties involved in a deal have to be approved by the SBV, and each party is not allowed to choose the other. The SBV also specifies the interest rate for each transaction.

Source: David Wong, *Viet Nam – Xem xet, danh gia ngan hang va thi truong tai chinh*, Bank of America, Nghien cuu chinh sach kinh te, Cac thi truong dang noi len o chau A, 5/1996.

3. The banking system and interest rate policy in 1998-99 under the impact of the East Asian financial crisis

With an inconvertible currency, a closed capital account, and a small M3 to GNP ratio, the Vietnamese banking system did not suffer any direct impact from the East Asian crisis. Accordingly, the SBV did not tighten interest rate controls in 1997 and early 1998: rather, it relaxed them. Interest rate ceilings were raised so that commercial banks, especially JSBs, were able to increase deposit rates in 1997. Against a background of the beginning of interest rate competition between banks, the regulation limiting the interest rate spread between lending and deposits to 0.35% per month was no longer effective and in the end it was abolished.

However, contrary to the government's predictions, the economy started to suffer a strong (though indirect) impact from the crisis from the middle of 1997. In the financial and banking sector, the quality of bank assets deteriorated when borrowing firms fell into difficulty due to decreased income, export, and FDI growth (Vuong Nhat Huong et al. [2002]). Many SOCB loans to SOEs became difficult to collect. In particular, importing firms had opened a number of deferred letters of credit (L/Cs) in 1995 and 1996, due at the end of 1997 or early 1998. The default on these L/Cs, which became more serious following the domestic currency devaluation of 10% in August 1998, forced banks to bear external debt burdens. Thus, some JSBs became virtually bankrupt.[2]

From the end of 1998, the government offered a series of measures to relieve the SOEs' financial difficulties, such extending loans to SOEs in difficulty from 1-3 years to 1-5 years, loaning to SOEs without collateral (not applicable to private enterprises),[3] and reducing lending rates.

There was an explosion in domestic credit in the economy through the banking system. Table 3 shows that credit growth was 2.8 times higher than income growth in 1997 and 1998; this figure went up to 4.0 in 1999 and 5.6 in 2000. The government's domestic credit promotion policy may have been aimed at two objectives: (i) helping the SOEs sustain production and employment in a difficult period; (ii) implementing an investment stimulation policy (instead of undertaking structural reforms) with the hope that income growth would recover.

What were the effects of interest rate reduction and credit relaxation? They were: (i) bank deposits were still stable despite interest rate reductions; (ii) the increase in domestic credit was not entirely due to the decrease in interest rates. Most of the credit increase was in the form of directed lending, including loans to SOEs, to the sugar development program, for infrastructure and to overcome the effects of natural disasters; (iii) credit to SOEs increased while deposits remained unchanged leading commercial banks to reduce their excess reserves and increase their borrowing from the SBV. In particular, when excess reserves became depleted, the SBV decided to reduce the required reserve ratio from 10% to 7% of short-term deposits in February 1999 (IMF [1999]).

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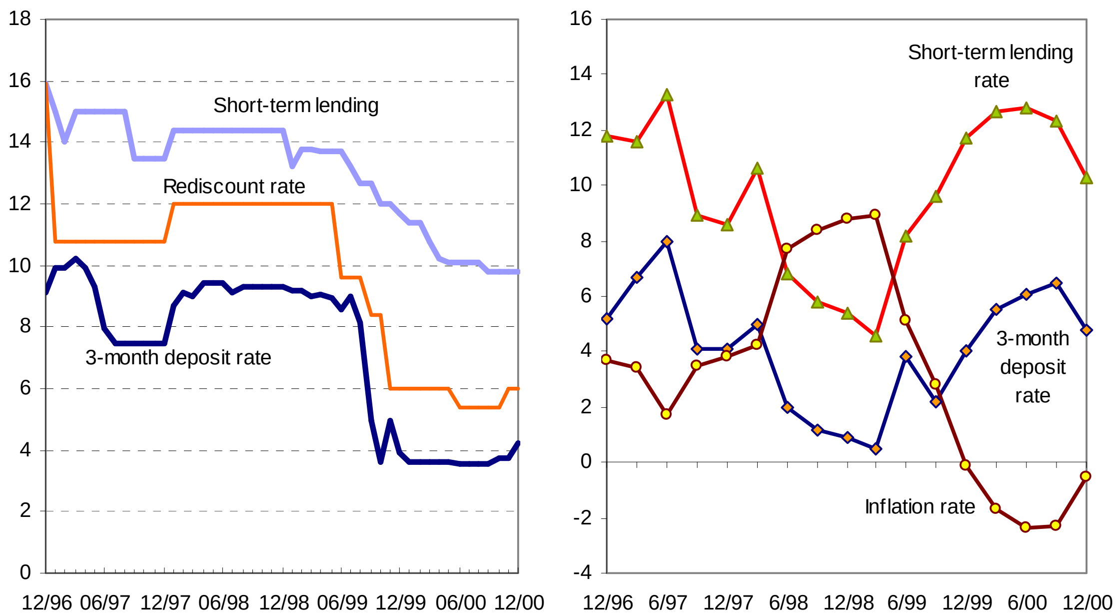
[2] According to the IMF (1999), the value of overdue L/Cs was USD550 million in mid-1998; there remained USD200 million unpaid by the end of 1998.

[3] By April 2000, a regulation on lending without collateral was applied to SOEs, shareholding companies (corporations), limited liability companies, households, cooperative groups, individuals borrowing funds from SOCBs, JSBs, credit funds, and credit cooperatives.

Figure 1. Interest rate reduction in 1999

Nominal interest rate (% per year) Real interest rate (% per year)



Source: IMF, *Vietnam: Selected Issues*, IMF Staff Country Report No 99/55, T7/1999.

Table 3: Growth of Domestic Credit, GDP, and Inflation (annual percentage)

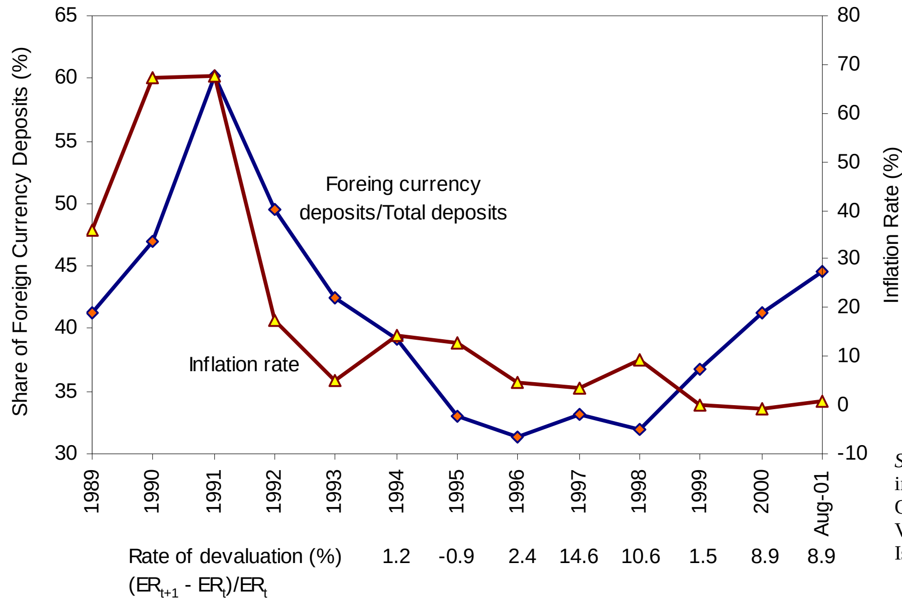
	1997	1998	1999	2000	2001
Domestic credit growth	22.6	16.4	19.3	38.1	21.5
State-owned enterprises	15.6	22.9	9.7	28.7	14.0
Other sectors	30.5	10.2	29.8	46.9	27.5
Money supply (M3) growth	26.1	25.6	39.1	38.9	25.5
GDP growth (at constant prices)	8.2	5.8	4.8	6.8	6.8
Inflation	3.6	9.2	0.1	-0.6	0.8

Source: World Bank, *Vietnam – Delivering on its Promise*, 2002.
General Statistical Office, Statistical Yearbook, 1997-2001.

4. Dollarization

The Vietnamese money market has experienced a strong dollarization process since the end of the 1980s, in which the US dollar and other foreign currencies have been increasingly used as a means of payment and a medium of value reserve. Figure 2 shows the foreign currency deposit to total deposit ratio, the inflation rate, and the exchange devaluation rate from 1989 to 2001.

Figure 2: Foreign currency deposits



Source: Based on data in the IMF Staff Country Report - Vietnam: Selected Issues, 1998-2002.

Foreign currency deposits increased sharply in 1991 and 1999. It has often been suggested that hyper-inflation at the end of the 1980s was the reason the US dollar replaced the domestic currency in transactions and deposits. Foreign currency deposits soared in 1991, accounting for 60.1% of total deposits. After 1991, the economic stabilization policy and decreased inflation caused the foreign currency deposit to total deposit ratio to reduce and it remained at 32-33% until 1999. The 2002 IMF Staff Country Report also concludes that the re-assimilation of a quantity of foreign currency previously outside of the banking system, the desire of savers to diversify their risk and export growth were factors contributing to the increase in foreign currency deposits and dollarization.

The impact of the regional crisis and the domestic currency devaluation in 1997 and 1998 led to a second surge in foreign currency deposits in 1999. Table 4 shows relatively high *nominal* interest rate spreads between the domestic currency and the US dollar. However, due to the devaluation of the domestic currency, the *real* interest rate on US dollar deposits was much higher than that on domestic currency deposits. If savers chose to deposit in various currencies based on the imbalance between real interest rates in the previous period, the results in Table 4 could account for the increase in foreign currency deposits to USD3.1 billion in 1999 from USD1.8 billion in 1998.

Table 4: Comparative real interest rates on USD and VND deposits in 1998 (percent per year)

	T3	T6	T9	T12
Nominal 6-month deposit rates				
VND (1)	11.9	12.8	12.4	12.4
USD (2)	5.1	5.1	5.1	4.9
Inflation (3)	4.2	7.7	8.4	8.8
Depreciation rate (4)	19.0	11.5	18.8	10.6

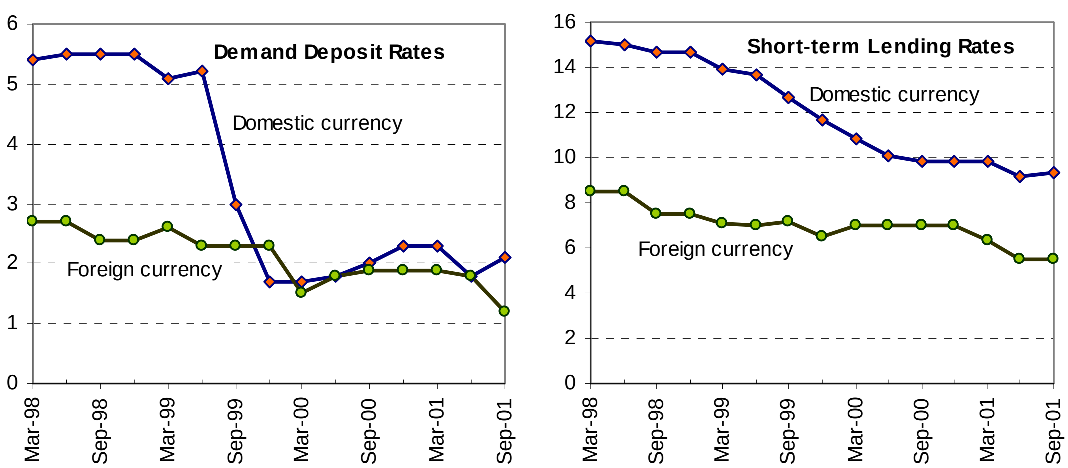
Real deposit rates				
VND (5)	7.4	4.7	3.7	3.3
USD (6)	20.0	8.8	15.2	6.6
Real USD-VND deposit rate spread	12.6	4.1	11.5	3.3

Notes: (1) Nominal quarterly VND deposit rate on annual average, i_V.
(2) Nominal quarterly USD deposit rate on annual average, i_U.
(3) Quarterly inflation rate on annual average, π.
(4) Quarterly exchange depreciation rate on annual average: $d = (ER_{t+1} - ER_t)/ER_t$.
(5) Real VND deposit rate: $r_V = (1 + i_V)/(1 + \pi) - 1$.
(6) Real USD deposit rate: $r_U = (1 + i_U)^*(1 + d)/(1 + \pi) - 1$.

Source: Data from the IMF and the author's calculations.

Figure 3 and the analysis in part 3 show a sharp fall in the domestic currency deposit rate since mid-1999. The nominal deposit rate spread between the US dollar and the dong almost disappeared. Hence, although there was virtually no inflation in 1999, it was still attractive to deposit in USD as the exchange rate (VND/USD) increased by 3.4%.

Figure 3: Nominal USD and VND interest rates (percent per year)



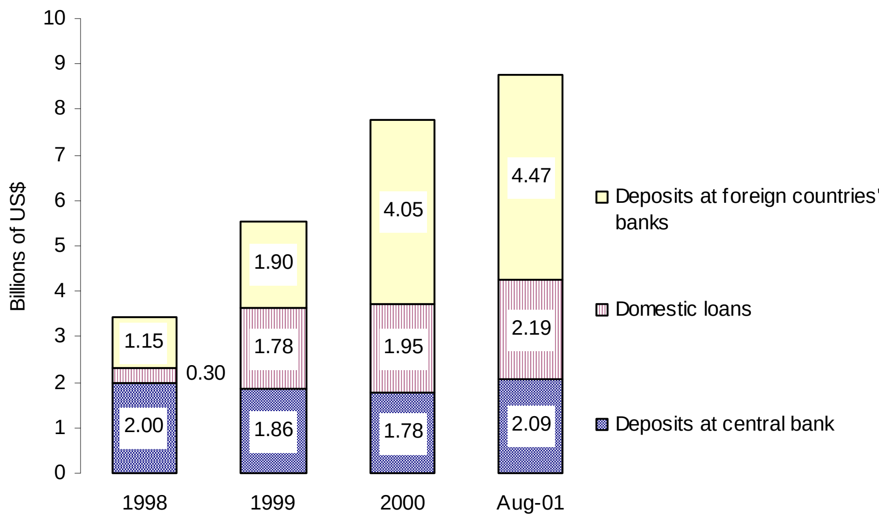
Source: Based on data from IMF Staff Country Report - Vietnam: Selected Issues, 1998-2002.

On the lending side, an interest rate discrepancy between domestic and foreign currency loans was still maintained, though it reduced together with the decrease in inflation.[4] While the level of foreign currency deposits increased in 1999, the growth in foreign currency loans did not catch up with the growth in deposits. According to SBV regulations, firms were only allowed to borrow in foreign currencies to pay for imported machinery and equipment or for services purchased from foreign organizations.[5] This regulation was not abolished until September 2000. Since then

[4] The SBV kept a lending rate ceiling on foreign currency loans. Short-term USD lending rates were not allowed to exceed the 3-month SIBOR plus 1% per year. Medium and long-term USD lending rates were not allowed to exceed the 6-month SIBOR plus 2.5% per year.
[5] The 1998 deferred L/C collapse partly explains the fact that the SBV continued to restrict access to foreign currency loans.

commercial banks have been allowed to extend credit to their customers in foreign currencies.[6] Foreign currency deposits in commercial banks increased and were transferred to the banks' accounts abroad to take advantage of the difference in interest rates (Figure 4).

Figure 4: Foreign currency assets in the Vietnamese banking system (in billions of USD)



Source: IMF, *Vietnam: Selected Issues and Statistical Appendix*, IMF Staff Country Report No 02/5, T1/2002.

II. FINANCIAL LIBERALIZATION 2000 -2002: STEP BY STEP

1. Banking reform

The 1999 expansionary credit policy did not stimulate economic growth. The slowdown in GDP and FDI growth following the East Asian crisis called for a faster pace to reform. The year 2000 was marked by a number of reforms to the banking system. The four SOCBs were independently audited using a system of loan classification and risk provision closer to international standards, and were recapitalized over a three-year period based on their performance and efficiency improvement. The JSBs were strengthened. A few JSBs were closed, some were placed under a special supervision regime, and some were merged. The number of JSBs was reduced by 40% in 2001 compared to the 2000 figure. The total cost of recapitalization and debt recovery was 24,000 billion VND (equivalent to 5% of GDP) by IMF estimates.

2. Base interest rate

In August 2000, the SBV adopted a new interest rate mechanism in which the domestic currency lending rates offered by commercial banks were to be adjusted according to a base interest rate announced by the SBV. However, lending rates charged by commercial banks were not allowed to exceed the base interest rate plus 0.3% per month for short-term loans or 0.5% per month for medium and long-term loans.

In principle, the base interest rate mechanism was not much different from the previous interest rate ceiling regime. However the new ceiling (the base rate plus the band) was much higher than the ceiling of the previous regime. Figure 5 shows that lending rates were always lower than the

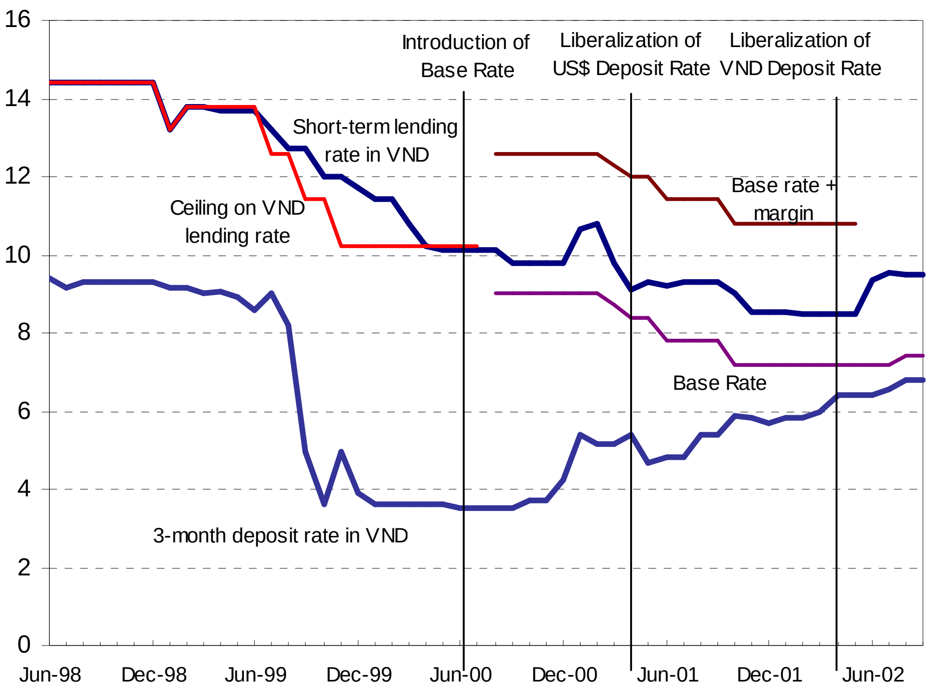
[6] By Thoi Bao Kinh Te Sai Gon, *Noi long viec cho vay ngoai te*, 7/9/2000.

band limit. Before adopting the base interest rate regime, the average lending rate offered by the four SOCBs had hit the ceiling (0.85% per month). In 1999, commercial banks had not been able to keep up with the five reductions in the interest rate ceiling made by the SBV; as a result, the average short-term lending rate had broken through the ceiling.

From August 2000, the base interest rate was set at a level that, with the addition of the band of 0.3% per month, exceeded the actual lending rate. Hence, following the implementation of the base interest rate mechanism, banks started setting lending rates on the basis of agreements with their customers.[7]

It is worth noting that the lending rates offered by commercial banks, though always higher than the base rate, changed in line with the base rate. Both lending and base rates of interest reduced in 2000 and 2001 while deposit rates were increasing. Competition between banks led to an increase in deposit rates, but the lending rates did not rise and remained within the band. Hence the interest rate spread reduced markedly.

Figure 5. From the interest rate ceiling to the base interest rate and interest rate liberalization, 1998-2002



Source: Calculated from the IFS database of IMF.

In general, there are three different views of the base interest rate regime. The first asserts that the base interest rate plus the band was no different from the previous ceiling, and hence had no impact on interest rates or the banks' fund raising and lending activities. In particular, both the base interest rate and interest rate ceiling regimes kept small borrowers (vendors, small household businesses, and individuals) away from the formal financial market. This was because the cost of lending to these customers is usually high, meaning that loans could not be made within the parameters set by the ceiling or the base rate plus the band.

[7] The interest rate band has not restricted lending rates, at least in urban areas. In rural areas, the use of agreed lending rates has been in place for a long time.

The second view emphasizes the advantages of the base interest rate regime. Within the band,[8] banks could set different lending rates based on the level of risk, rather than having to set the same lending rate for all customers as previously. This resulted in increased competition among credit institutions, thereby leading to an improvement in the efficiency of resource allocation. Furthermore, actual lending rates, though not breaching the band, tended to change in line with the base interest rate. In fact, the SBV in many cases changed the base rate following changes in the market interest rate. This signaled a first step to full interest rate liberalization had been made.

The third is a pessimistic view of the new interest rate regime. In this view, the fact that banks were free to set lending rates while the SOEs reformed slowly would exacerbate the inherently unhealthy financial relationship between these two entities. This is because banks were willing to loan to the bailed-out SOEs at an interest rate of 0.6 - 0.65% per month while the private sector would have to pay interest of 0.75 - 0.8% per month since banks regard them as being a higher risk.

3. Interest rate liberalization

The lending rate ceiling on foreign currency loans was abolished in November 2001. Since then domestic borrowers in foreign currencies have been allowed to negotiate interest rates with domestic and foreign banks. Interest rates were fully liberalized in June 2002. Banks are now allowed to set lending rates on the basis of their own appraisal and negotiation with their customers.

As just discussed, banks have been actively setting their deposit and lending rates since the base interest rate regime was applied. With the official liberalization of interest rates, the base interest rate announced by the SBV has become just a reference. Deposit rates have continued to increase. At the same time, lending rates started inching up right after the liberalization decision.

Box 3. The interest rate race

"The VCB has increased its VND deposit rates several times in one month. On July 10, 2002, the bank announced the highest VND deposit rates among SOCBs and much higher than those of many JSBs (0.6% per month for 3-month deposits, 0.65% for 6-month deposits, and 0.67% for 12-month deposits). The announcement of the plan by the VCB to issue Certificates of Deposit (CDs) at the highest rates in the banking system has sparked fierce competition between rivals. In July 29, the VCB started to offer CDs with three maturities (6, 9, and 12 months) at interest rates of 0.67%, 0.69%, and 0.7% per month, respectively.

"When issuing CDs to raise VND funds, banks normally specify the amount expected to be raised and the time during which the CDs, usually of only one maturity, are offered. Yet the CDs offered by the VCB are of three different maturities, while the amount expected to be raised and the offer time are not disclosed. Experts have said that in doing so, the VCB's actions amount to an increase in deposit rates for a second time within one month. A joint-stock bank leader in Hanoi has said, “The VCB’s decision to increase deposit rates, and then issue CDs at such high interest rates are a shock not only to us but to all banks in the system”.

"There have been large fluctuations in the market in the week following the CD issue. By late afternoon of August 2, 2002, the money market was in turmoil. There were sharp movements in the saving funds in commercial banks. Plans by other SOCBs to issue CDs have also been affected. The ICB is issuing 6-month VND CDs, but at only 0.65% per month (lower than those offered by the VCB) and starting from August 1, 2002 (3 days later than the VCB). The BIDV, at certain branches, is offering 3-month CDs at an interest rate of 0.65% per month prepaid (equivalent to 0.66% per month postpaid)… According to one expert, the SOCBs will have to adjust their deposit rates to avoid running short of VND.

[8] The bands of 0.3% per month for short-term loans and 0.5% per month for medium and long term loans are regarded as reasonable in this view.

"Mrs. Bui Thi Mai, the COE of the Habubank, a joint-stock bank in Hanoi, said, "While it is hard to increase lending rates, we have been forced to increase deposit rates due to the effect of the increases in interest rates made by the other banks. If we do not increase our rates, our customers will leave us". Hence, from today, deposit rates offered by Habubank have also increased (the 12-month deposit rate is 0,7% per month, equal to the rate on the VCB's CDs)."

Source: Extract from Thanh Nien Newspaper, *Cac ngan hang se tiep tuc tang lai suat huy dong*, August 5, 2002 (on VNExpress).

The skeptical view on interest rate liberalization states that competition between banks in the absence of controls will lead to "big fish eating the small fish." Smaller banks will find it difficult to lend at low rates in order to compete with the larger banks.[9] In particular, the JSBs seem unable to reduce deposit rates so as to lower lending rates since borrowers are likely to withdraw money. In contrast, they tend to increase deposit rates, and then invest in risky projects due to the combined impact of adverse selection and moral hazard under competitive pressure and in the absence of an interest rate ceiling or a base rate-plus-band limit. Increases in deposit and lending rates following liberalization tend to prove this argument (see Box 3).

By Phan Le of the Thoi Bao Kinh te Viet Nam on January 9, 2003:

"Since the implementation of agreed rate lending in VND, credit institutions have been involved in a fierce interest rate competition for deposits. … With the high VND deposit rates offered by SOCBs, the JSBs have had to surrender. ... The competition for VND deposits through offering high interest rates has led to a movement of funds from bank to bank, even from area to area. The cost to the credit institutions of raising funds in VND has increased, meaning that the interest rate on loans in VND made by the credit institutions has also had to increase. ... The agreed lending rate system has wiped out the State's management role from the field of interest rates on bank lending in VND!"

In contrast to the above objection to interest rate liberalization, its proponents argue for liberalization with a similar reasoning to that of the previous base interest rate regime. Policy makers hope that now interest rates can reflect the supply of and the demand for funds in the market. Furthermore, as the base rate is only a reference, banks can lend to small businesses or farmers at rates reflecting the cost of lending and the risk.

The Governor of the SBV Le Duc Thuy considers that,

"The biggest advantage of this [interest rate liberalization] is that it sets the conditions for the credit institutions to expand their fund raising and lending activities at appropriate levels of interest, meeting the borrowers' needs for funds in full and in a more timely fashion. ... Another effect of the new regime is to facilitate market-oriented banking reforms so as to enhance the financial capability, competitiveness, safety standards and the ability to integrate into the international financial and money markets of all Vietnamese financial institutions."

(VNExpress, Thanh Nien Newspaper, *Tu do hoa lai suat cho vay: Coi troi cac to chuc tin dung*, 31/5/2002.)

Similarly, the Deputy COE of the VCB Nguyen Hoa Binh comments on the decision to deregulate foreign currency lending rates:

[9] Many banks proposed an interest rate floor to stop lending rate competition. However, experiences from the previous negotiations by the four SOCBs for a minimum lending rate, which they then themselves violated suggest that an effort to maintain a cartel is extremely difficult, if not impossible.

> "…the above decision of the SBV will have a deep and far-reaching effect on the market; the coming positive impact can clearly be seen. Differentiation between customers will become clearer: Creditworthy customers will enjoy lower lending rates while non-creditworthy customers will bear significantly higher rates."
>
> (VNExpress, Dien Dan Doanh Nghiep, *Hau tu do hoa lai suat cho vay USD*, 7/6/2002.)

The proponents of liberalization do not attribute the increases in interest rates to the abolition of the lending rate band. In their opinion, the increases in interest rates reflect the shortage of funds in 2002, and in fact interest rates had been increasing for many months prior to the liberalization decision. Bank loans were not sufficient to meet the demand for funds, especially for medium and long-term funds, in 2001 and 2002.

The Deputy COE of the ICB Trinh Cong Thang asserted that,

> "… in general, this [increase in interest rates] comes from a market signal. The increased demand for loans has led to an increase in the price of funds, and the previous rates of interest were not appropriate, and hence, have had to increase. In addition, other rates of interest, such as on Treasury bonds or bonds of Development Promotion Funds, are also rather high (more than 7% per year), requiring banks to increase their interest rates appropriately."
>
> (VNExpress, Dau Tu Newspaper, *Lai suat tang do mat can doi von*, 12/8/2002.)

While domestic currency interest rates have increased, rates on both foreign currency lending and deposits have not moved although the foreign currency lending rates were liberalized before the domestic currency lending rates. The Deputy COE of the VCB Nguyen Hoa Binh concluded that,

> "The short-term foreign currency lending rates may change slightly but the medium and long-term foreign currency lending rates are unlikely to fluctuate, since commercial banks generally have not reached the maximum limit of 6-month SIBOR plus 2.5% per year."
>
> (VNExpress, Dien Dan Doanh Nghiep, *Hau tu do hoa lai suat cho vay USD*, 7/6/2002.)

Others argue that the fact that the US Federal Reserve has been continuously cutting interest rates has kept the USD lending rates at low levels in Vietnam. Domestic currency deposits did actually increase more rapidly than foreign currency deposits in 2002. And the USD lending rate of 2.85 - 3% per year in early 2003 has been inducing firms to borrow in foreign currencies.

CONCLUDING REMARKS

At the time of writing, interest rates in Vietnam have been liberalized for 8 months, too short a time period to assess fully the impact of the new regime on interest rates, banking activities and the economy. This paper discusses interest rate policy in Vietnam prior to interest rate liberalization, and summarizes various views and comments by the government officials, bankers, and researchers on the new interest rate regime based on agreement between lenders and borrowers.

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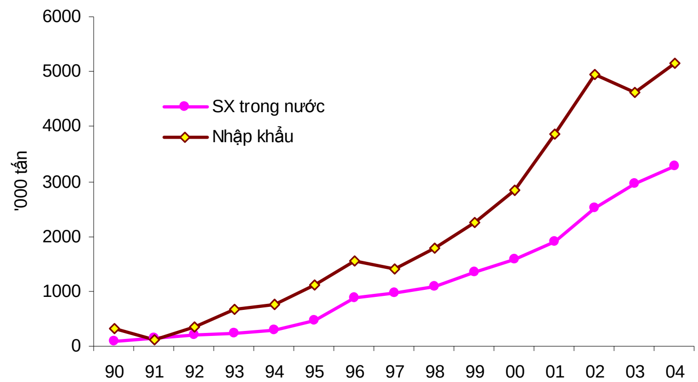
Exhibit 1: Domestic Produced and Imported Steel Outputs



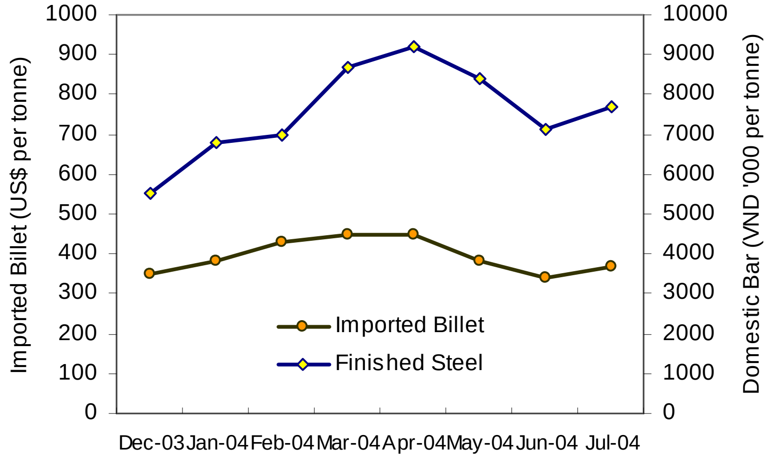
Source: **GSO, "Vietnam Statistics Year Book".**

Exhibit 2: Domestic steel output by sectors

	Rolled steel output ('000 tones)				Growth rate (%/year)				Structure (%)		
Year	Total	State	Private	FDI	Total	State	Private	FDI	State	Private	FDI
1990	101	-	-	-		-	-	-	-	-	-
1991	149	-	-	-	47,5	-	-	-	-	-	-
1992	196	-	-	-	31,5	-	-	-	-	-	-
1993	243	-	-	-	24,0	-	-	-	-	-	-
1994	279	-	-	-	14,8	-	-	-	-	-	-
1995	470	398	10	62	68,5	-	-	-	84,7	2,1	13,2
1996	868	503	15	350	84,7	26,4	50,0	464,5	57,9	1,7	40,3
1997	978	486	8	484	12,7	-3,4	-46,7	38,3	49,7	0,8	49,5
1998	1.077	504	22	551	10,1	3,7	175,0	13,8	46,8	2,0	51,2
1999	1.357	502	146	709	26,0	-0,4	563,6	28,7	37,0	10,8	52,2
2000	1.583	567	175	841	16,7	12,9	19,9	18,6	35,8	11,1	53,1
2001	1.914	694	305	915	20,9	22,4	74,3	8,8	36,3	15,9	47,8
2002	2.503	796	567	1.140	30,8	14,7	85,9	24,6	31,8	22,7	45,5
2003	2.954	908	1.207	839	18,0	14,1	112,9	-26,4	30,7	40,9	28,4
2004	3.279	1.252	1.187	840	11,0	37,9	-1,7	0,1	38,2	36,2	25,6
2005	3.888	1.440	1.580	868	18,6	15,0	33,1	3,3	37,0	40,6	22,3

Source: GSO, "Vietnam Statistics Year Book".

Exhibit 3: Domestic Prices of Imported Billets and construction Steel



Source: Authors' estimates.

Exhibit 4: Vietnam' Steel Producers

No.	Name	Location	Capacity (tone per year)
1	Công ty Gang thép Thái nguyên	Thái Nguyên	240,000
2	Công ty Thép miền Nam	TP.HCM	460,000
3	Công ty Thép Đà Nẵng	Đà Nẵng	40,000
4	Công ty Kim khí va VTTH miền Trung	Đà Nẵng	20,000
5	Công ty Thép Vinakyoei	Bà Rịa - Vũng Tàu	300,000
6	Công ty Thép VSC-POSCO	Hải Phòng	200,000
7	Công ty Thép Natsteelvina	Thái Nguyên	110,000
8	Công ty Thép Vinasteel	Hải Phòng	180,000
9	Công ty Thép Tây Đô	Cần Thơ	120,000
10	Công ty Vinatafong	Bình Dương	230,000
11	Công ty Thép Nam Đô	Hải Phòng	120,000
12	Nhà máy Cơ khí Cẩm Phả	Quảng Ninh	15,000
13	Công ty Cơ khí Duyên Hải	Hải Phòng	17,000
14	Công ty Thành Đạt	Hải Phòng	20,000
15	Công ty Diesel Sông Công	Thái Nguyên	15,000
16	Công ty Tuyến Năng	Hà Nội	25,000
17	Công ty Vũ Linh	Hà Nội	20,000
18	Công ty Hoàng Lê	Hà Nội	10,000
19	Công ty Beton thép Ninh Bình	Ninh Bình	15,000
20	Công ty Phá dỡ tàu cũ Kỳ Hà	Quảng Nam	25,000
21	Công ty Hồng Châu	TP.HCM	15,000

22	Công ty Đồng Tâm	TP.HCM	30,000
23	Công ty 89 Bộ Quốc Phòng	Hà Nội + TP.HCM	42,000
24	Hợp tác xã Cơ khí Đại Thành	TP.HCM	15,000
25	Công ty Thép Tân Việt Thành	TP.HCM	15,000
26	Công ty Quốc Huy	Bình Dương	15,000
27	Công ty An Hưng Tường	Bình Dương	20,000
28	Công ty Thép Long An	Long An	15,000
29	Công ty Cơ khí Hà Nội	Hà Nội	10,000
30	Làng nghề Đa Hội	Bắc Ninh	190,000
31	Công ty Cổ phần Thép Hải Phòng	Hải Phòng	180,000
32	Công ty Kết cấu thép SSE (VII)	Hải Phòng	200,000
33	Công ty thép An Việt	Bình Dương	200,000
34	Công ty Thép Hòa Phát	Hải Dương	200,000
35	Công ty Thép Sông Đà	Hưng Yên	125,000

Exhibit 5: World Steel Prices

Unit: US$ per tone

Date	Hot Rolled Coil	Hot Rolled Plate	Cold Rolled Coil	Wire Rod	Rebar
Jun-02	304	302	363	265	255
Jul-02	319	312	390	273	264
Aug-02	320	313	391	273	264
Sep-02	319	318	396	273	263
Oct-02	318	316	398	270	257
Nov-02	322	318	401	271	255
Dec-02	317	318	399	268	255
Jan-03	333	327	411	276	263
Feb-03	339	333	420	289	275
Mar-03	340	332	424	300	286
Apr-03	340	335	426	296	286
May-03	336	342	425	301	289
Jun-03	333	346	425	302	289
Jul-03	329	346	421	303	302
Aug-03	327	343	418	300	300
Sep-03	333	346	420	299	308
Oct-03	341	357	430	314	323
Nov-03	343	361	427	315	318
Dec-03	354	367	434	323	327
Jan-04	386	400	474	348	355
Feb-04	414	432	501	396	404
Mar-04	474	506	563	479	503
Apr-04	513	540	596	498	517
May-04	549	575	614	498	511

Source: MEPS World Steel Prices at http://www.meps.co.uk.

Exhibit 6: Global Steel Consumption Outlook

	Million tones				Annual % Change			
	2002	2003	2004e	2005e	2002	2003	2004e	2005e
China	186	232	263	290	21.0	25.2	13.1	10.4
Japan	72	74	74	73	-2.0	2.9	0.3	-1.4
Other Asia	142	147	151	155	11.9	3.5	2.6	2.7
EU-15	139	140	143	146	-1.2	0.9	2.3	1.9
Other Europe	38	42	44	45	4.7	11.2	3.9	4.0
CIS	30	31	32	33	-3.0	2.7	2.6	2.3
NAFTA	133	131	139	141	2.3	-1.7	6.0	2.0
South America	27	28	31	33	-3.2	2.2	11.7	5.9
Africa	17	17	18	19	7.0	-1.5	7.3	2.4
Middle East	21	22	22	23	10.6	3.0	3.1	3.0
World	805	864	917	958	6.6	7.3	6.2	4.5

Source: International Iron & Steel Institute (IISI), The Short Range Outlook for 2004 - 2005 for the Apparent Consumption of Finished Steel Products, 30 April 2004

DATA APPENDIX

Table 1: Basic economic Indicators

Vietnam	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001e	2002e
									In billions of dong									
GDP (at current prices)	117	599	2,870	15,420	28,093	41,955	76,707	110,532	140,258	178,534	228,892	272,036	313,623	361,016	399,942	441,646	484,493	536,000
GDP (at 1994 prices)	106,176	109,189	113,154	119,960	125,571	131,968	139,634	151,782	164,043	178,534	195,567	213,833	231,264	244,596	256,272	273,582	292,376	314,000
Fixed asset accumulation (at current prices)	14	75	421	2,214	4,114	6,025	11,506	19,498	34,020	45,483	62,131	76,450	88,754	104,875	110,503	130,771	149,621	…
Fixed asset accumulation (at 1994 prices)	12,646	16,136	19,858	20,505	20,434	20,148	22,366	27,086	39,862	45,483	53,249	60,826	66,529	74,931	75,830	84,033		…
Exports (in millions of USD)	699	789	854	1,038	1,946	2,404	2,087	2,581	2,985	4,054	5,449	7,256	9,185	9,360	11,541	14,483	15,027	16,230
Imports (in millions of USD)	1,857	2,155	2,455	2,757	2,566	2,752	2,338	2,541	3,924	5,826	8,155	11,144	11,592	11,450	11,742	15,637	16,162	19,300
									Percent per year									
GDP growth rate	…	2.8	3.6	6.0	4.7	5.1	5.8	8.7	8.1	8.8	9.5	9.3	8.2	5.8	4.8	6.8	6.8	7.0
Increase in fixed asset accumulation	…	27.6	23.1	3.3	-0.3	-1.4	11.0	21.1	47.2	14.1	17.1	14.2	9.4	12.6	1.2	10.8	…	…
Fixed asset accumulation/GDP	12.0	12.5	14.7	14.4	14.6	14.4	15.0	17.6	24.3	25.5	27.1	28.1	28.3	29.0	27.6	29.6	30.9	…
Export growth rate	7.5	13.0	8.2	21.6	87.4	23.5	-13.2	23.7	15.7	35.8	34.4	33.2	26.6	1.9	23.3	25.5	3.8	10.0
Import growth rate	6.4	16.0	13.9	12.3	-6.9	7.3	-15.1	8.7	54.4	48.5	40.0	36.6	4.0	-1.2	2.1	33.2	3.4	19.4
Trade balance/GDP	…	…	…	…	-10.2	-4.5	-3.2	0.4	-7.6	-10.6	-13.0	-15.8	-9.1	-8.0	-0.7	-3.8	-3.5	-8.8
Fiscal deficit/GDP	…	…	…	…	…	…	…	…	…	…	-0.5	-0.2	-1.7	-0.5	-1.6	-2.8	-3.4	…
Inflation	…	774.7	223.1	349.4	36.0	67.1	67.6	17.5	5.2	14.4	12.7	4.5	3.6	9.2	0.1	-0.6	0.8	4.0

Source: General Statistical Office. Statistical Yearbook. 1997-2001.

Table 2: Monetary Indicators

	1992	1993	1994	1995	1996	1997	1998	1999[a]	1999[b]	2000	2001	2002[c]
					In trillions of dong. end of year							
Net foreign currency assets	10.6	6.6	6.9	10.9	14.3	21.0	31.2	61.7	61.2	95.7	117.6	131.0
Assets	14.2	10.7	17.0	24.7	31.2	37.9	47.0	74.7	77.7	112.7	135.9	149.9
Liabilities	-3.6	-4.2	-10.0	-13.9	-17	-16.9	-15.8	-13.0	-16.5	-17.0	-18.3	-18.9
Net domestic currency assets	16.6	26.6	36.1	41.9	50.4	60.6	71.3	81.1	99.2	127.2	162.2	204.5
Domestic credit	17.1	27.8	38.0	47.1	55.3	66.8	81.1	89.6	115.7	155.2	191.2	233.5
Net credit to government	1.9	3.9	4.6	4.7	4.4	4.4	8.4	2.9	3.0	-0.5	2.1	5.6
Net credit to the economy	15.2	23.9	33.4	42.4	50.9	62.4	72.7	86.7	112.7	155.7	189.1	227.9
Credit to SOEs	12.4	15.9	20.5	24.1	26.8	31.0	38.1	41.8	54.3	69.9	79.7	89.3
Credit to others sectors	2.8	8.0	12.9	18.3	24.1	31.4	34.6	44.9	58.4	85.8	109.4	138.6
Other items. net	-0.6	-1.2	-1.9	-5.2	-4.9	-6.2	-9.8	-8.5	-16.5	-28.0	-29.0	-29.0
Broad money	27.1	33.1	43.0	52.7	64.7	81.6	102.5	142.6	160.5	222.9	279.8	335.5
Cash and domestic currency deposits	18.9	25.1	33.5	41.6	51.5	62.9	78.4	105.4	116.7	152.5	191.1	237.9
Currency outside banks	10.6	14.2	18.6	19.2	22.6	25.1	27.0	41.5	41.4	…	…	…
Demand deposits	4.2	4.9	5.1	7.4	10.8	14.9	20.2	…	…	…	…	…
Other deposits	4.1	6.0	9.8	15.1	18.1	22.9	31.1	…	…	…	…	…
Foreign currency deposits	8.2	8.0	9.5	11.1	13.2	18.7	24.1	37.2	43.8	70.4	88.7	97.6
					Growth rate (percent. compared to the same period)							
Net credit to the economy	…	57.1	39.8	26.9	20.0	22.6	16.5	19.3	…	38.2	21.5	20.5
Credit to SOEs	…	27.7	28.9	17.7	11.2	15.7	22.9	9.7	…	28.7	14.0	12.0
Credit to other sectors	…	188.8	61.8	41.4	31.7	30.3	10.2	29.8	…	46.9	27.5	26.8
Broad money	…	22.0	29.9	22.5	22.8	26.1	25.6	39.1	…	38.9	25.5	19.9
Cash and domestic currency deposits	…	32.5	33.5	24.3	23.8	22.1	25.6	34.4	…	38.9	25.5	24.5
Foreign currency deposits	…	-2.1	18.5	16.5	18.9	41.7	24.6	54.4	…	30.7	25.3	10.0

Note: a. Data from 1997 to 1999a cover the SBV, four SOCBs, and 24 nonstate-owned banks .
b. Data from 1999b to 2002 cover the SBV, six SOCBs, and 83 nonstate-owned banks .
c. Data under the plan.

Source: World Bank, , *Vietnam – Delivering on its Promise*, Development Report 2003, T12/2002, and the IMF, *Vietnam: Selected Issues*, IMF Staff Country Report, 1998-2002.

Table 3: Interest rates (percent per year)

	1989	1990	1991	1992	1993	1994	1995	1996	97-3	97-6	97-9	97-12	98-3	98-6	98-9	98-12	99-3	99-6	99-9	99-12	00-3	00-6	00-9	00-12	01-3	01-6	01-9
Deposit rates																											
Demand deposits	23.9	11.4	12.7	3.7	1.2	1.2	8.7	6.2	6.5	6.2	4.6	4.6	5.4	5.5	5.5	5.5	5.1	5.2	3	1.7	1.7	1.8	2	2.3	2.3	1.8	2.1
3-month deposits	125.2	60.1	51.1	26.8	18.2	18.2	18.2	9.1	10.4	9.9	7.8	8.1	9.4	9.9	9.7	9.7	9.4	9.1	5.1	4.0	3.7	3.6	4.1	4.3	5.1	4.9	5.5
Demand foreign currency	…	…	…	…	…	…	…	…	…	…	…	…	2.7	2.7	2.4	2.4	2.6	2.3	2.3	2.3	1.5	1.8	1.9	1.9	1.9	1.8	1.2
6-month foreign currency	…	…	…	…	…	…	…	…	…	…	…	…	5.1	5.1	5.1	4.9	4.9	4.7	4.8	4.5	3.8	4.2	4.8	4.8	4.0	3.2	2.7
Lending rates																											
Short-term	…	…	…	37.7	28.3	28.3	28.3	15.9	15.4	15.2	12.7	12.7	15.2	15.0	14.7	14.7	13.9	13.7	12.7	11.7	10.8	10.1	9.8	9.8	9.8	9.2	9.3
Medium and long-term	…	10.0	10.0	23.9	15.4	22.4	22.4	17.3	16.9	16.9	14.0	14.0	15.7	15.9	15.4	15.2	14.7	14.0	12.7	11.7	11.4	10.4	10.4	10.4	11.7	10.3	10.3
Foreign currency	…	…	…	…	7.5	9.0	9.5	9.5	9.5	9.5	8.5	8.5	8.5	8.5	7.5	7.5	7.1	7.0	7.2	6.5	7.0	7.0	7.0	7.0	6.3	5.5	5.5
Interest rate spread [a]	-33.1	-14.5	-5.8	8.7	8.7	10.2	10.2	6.8	5.0	5.3	4.9	4.6	5.8	5.1	5.0	5.0	4.5	4.6	7.6	7.7	7.1	6.5	5.6	5.5	4.7	4.3	3.8
Real interest rates [b]																											
Demand deposits	…	…	…	…	…	-11.1	-4.9	2.4	3.0	4.4	1.0	0.8	1.1	-2.0	-2.6	-3.0	-3.5	0.1	0.3	1.7	3.5	4.3	4.3	2.8	3.8	2.6	1.5
3-month deposits	73.5	65.7	-36.4	11.4	14.0	3.7	3.5	5.2	6.7	8.0	4.1	4.1	5.0	2.0	1.2	0.9	0.5	3.8	2.2	4.0	5.5	6.1	6.5	4.8	6.5	5.8	4.9
Demand foreign currency deposits	…	…	…	…	…	…	…	…	…	…	…	…	17.4	6.3	12.2	4.1	-6.1	-2.1	0.9	3.9	4.5	4.9	5.5	11.4	6.9	5.3	9.6
6-month foreign currency deposits	…	…	…	…	…	…	…	…	…	…	…	…	20.0	8.8	15.1	6.6	-4.0	0.2	3.4	6.2	6.8	7.4	8.6	14.7	9.1	6.8	11.1
Short term loans	…	…	…	21.0	23.9	12.7	12.4	11.8	11.6	13.3	8.9	8.6	10.6	6.8	5.8	5.4	4.6	8.2	9.6	11.7	12.7	12.8	12.3	10.3	11.3	10.1	8.7
Medium and long-term loans	0.0	-57.6	-4.7	8.7	11.4	7.5	7.3	13.2	13.1	15.0	10.2	9.9	11.1	7.6	6.5	5.9	5.3	8.4	9.6	11.7	13.4	13.1	13.0	10.9	13.2	11.2	9.6
Foreign currency loans	…	…	…	…	…	-3.1	-4.9	8.1	14.2	22.2	6.0	19.8	24.0	12.4	17.8	8.3	-2.0	2.4	5.8	8.2	10.2	10.2	10.9	17.1	11.5	9.1	14.1
Dong depreciation rate [c]	…	…	…	…	…	1.2	-0.9	2.4	7.8	13.5	1.1	14.6	19.0	11.5	18.8	10.6	-0.3	0.6	1.4	1.5	1.2	0.6	1.3	8.9	3.5	2.7	8.9
Inflation	37.7	143.6	75.5	14.0	3.7	13.9	14.1	3.7	3.4	1.7	3.5	3.8	4.2	7.7	8.4	8.8	8.9	5.1	2.8	-0.1	-1.7	-2.4	-2.3	-0.5	-1.4	-0.8	0.6

Note: a. The difference between the short-term lending rate and the 3-month deposit rate .
b. The nominal interest rate at the end of the quarter minus the monthly average inflation during the quarter.
c. The average depreciation rate in the previous quarter, on yearly average.
Source: World Bank, *Vietnam Financial Sector Review*, 1995, and IMF, *Vietnam: Selected Issues*, IMF Staff Country Report, 1998-2002.

Table 4: The lending rate ceiling and the base interest rate (percent per year)

	6-12/1998	2-6/1999	7-8/1999	9-10/1999	11/1999-7/2000	8/2000-2/2001	3/2001	4-9/2001	10/2001-7/2002	8-12/2002
Lending rate ceiling	14.40	13.80	12.60	11.40	10.20					
Base interest rate						9.00	8.70	8.40	7.20	7.44