



Monetary Stability in Vietnam

Risk Vietnam 2012 Conference

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Road Map



- The past and the present
 - ✓ Growth, inflation, and macroeconomic policies
 - ✓ The banking system, credit growth, and macrofinancial linkages
- The future: A framework for monetary and exchange rate stability



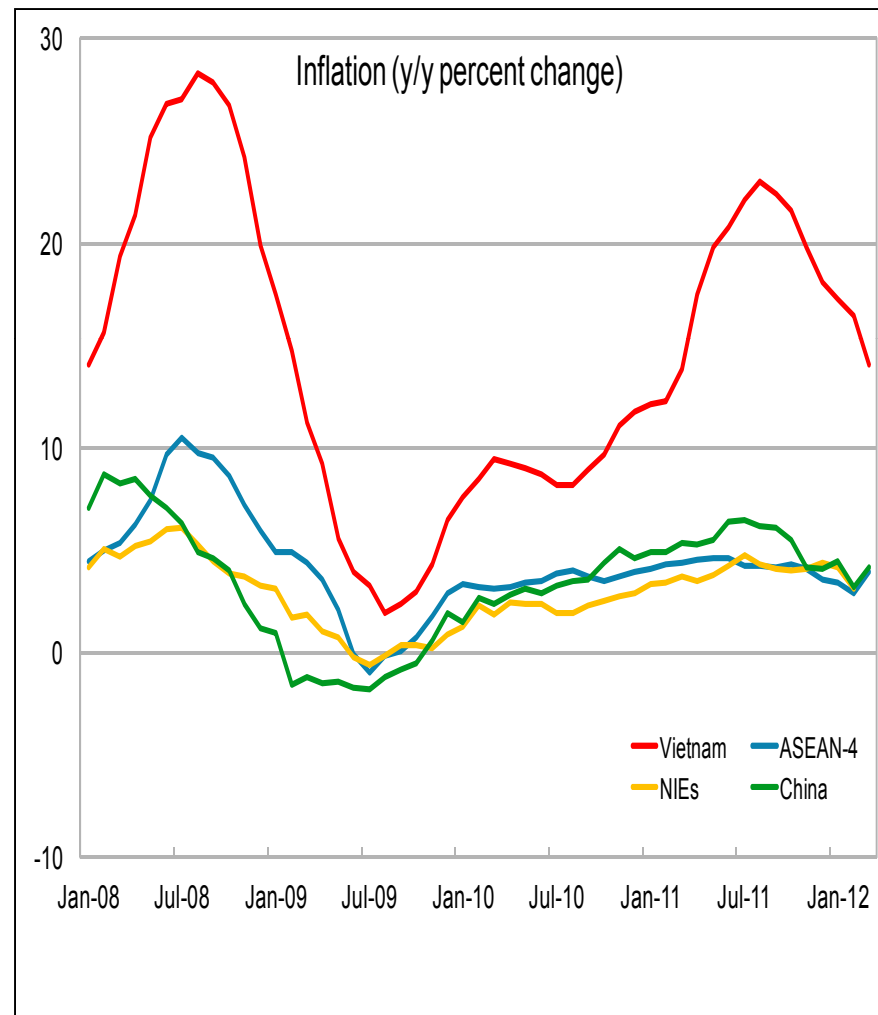
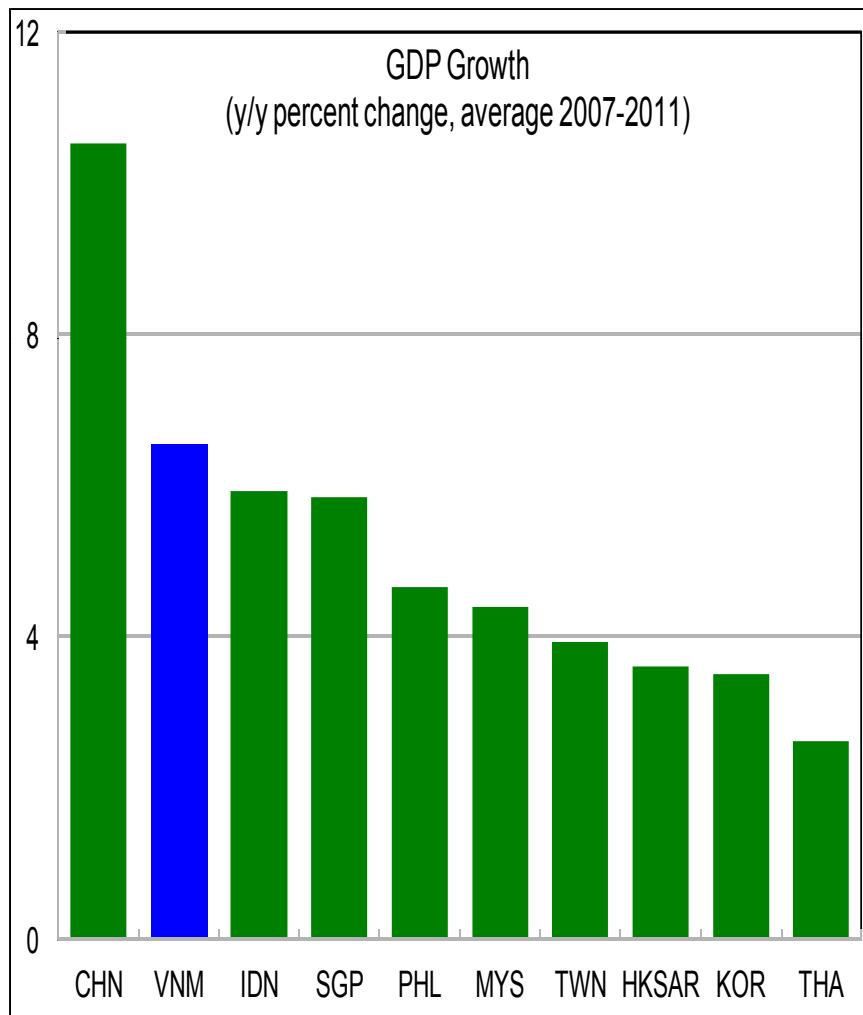
The Past and the Present

The past and the present

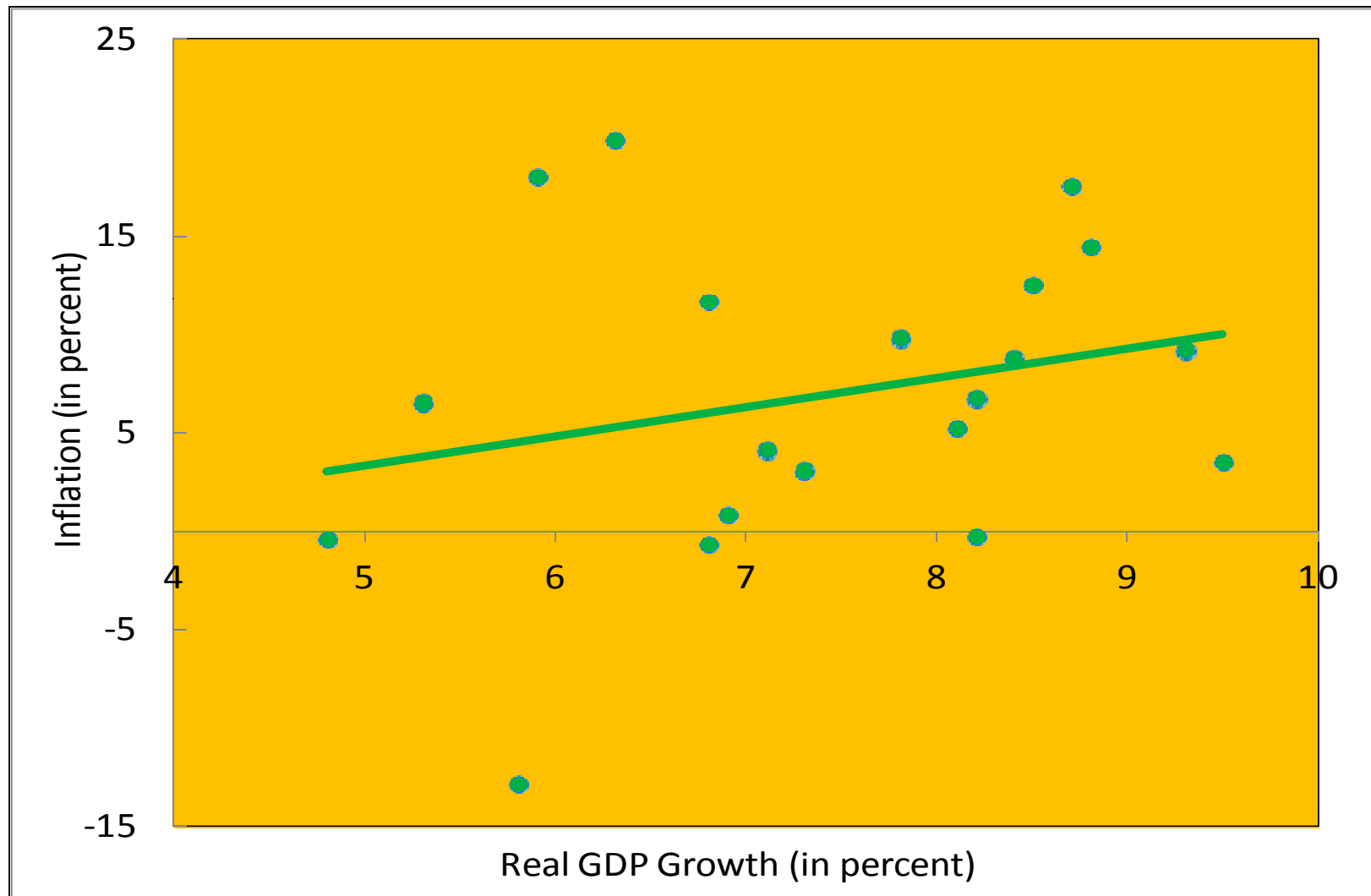


- Growth and inflation—The tradeoff
- Balance of payments and international reserves
- Macroeconomic policies and administrative controls

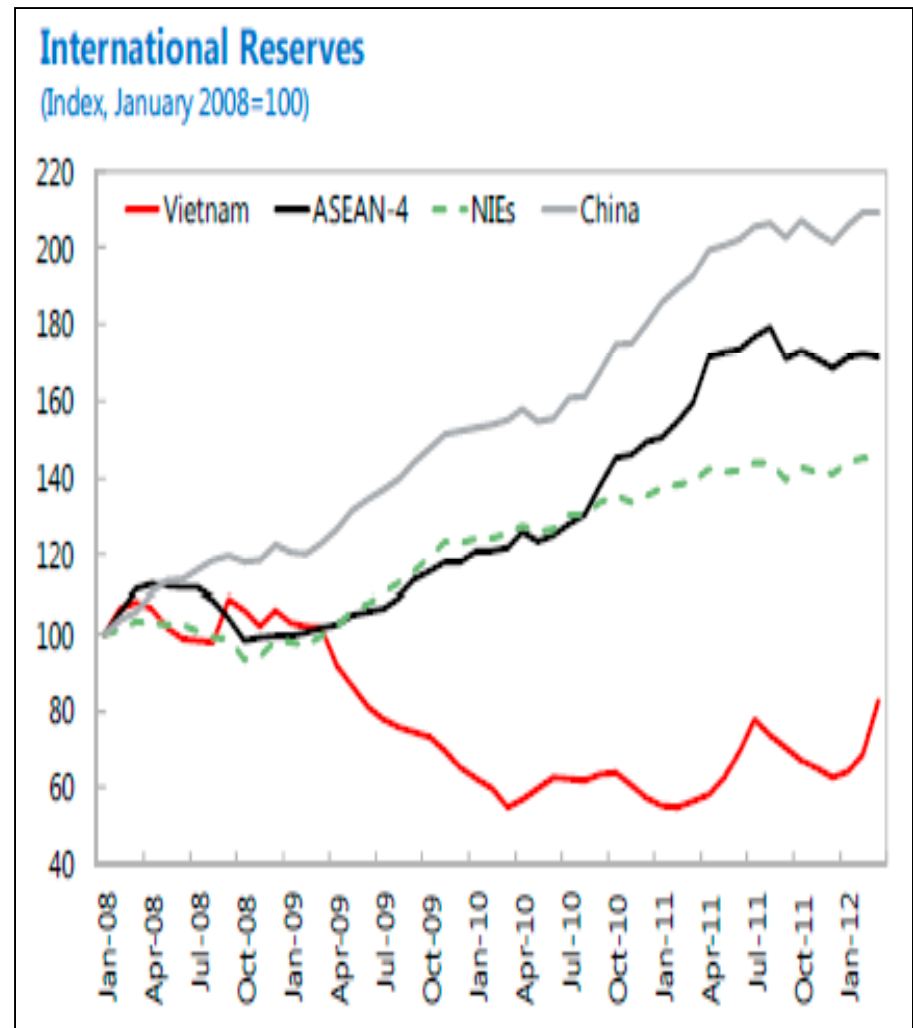
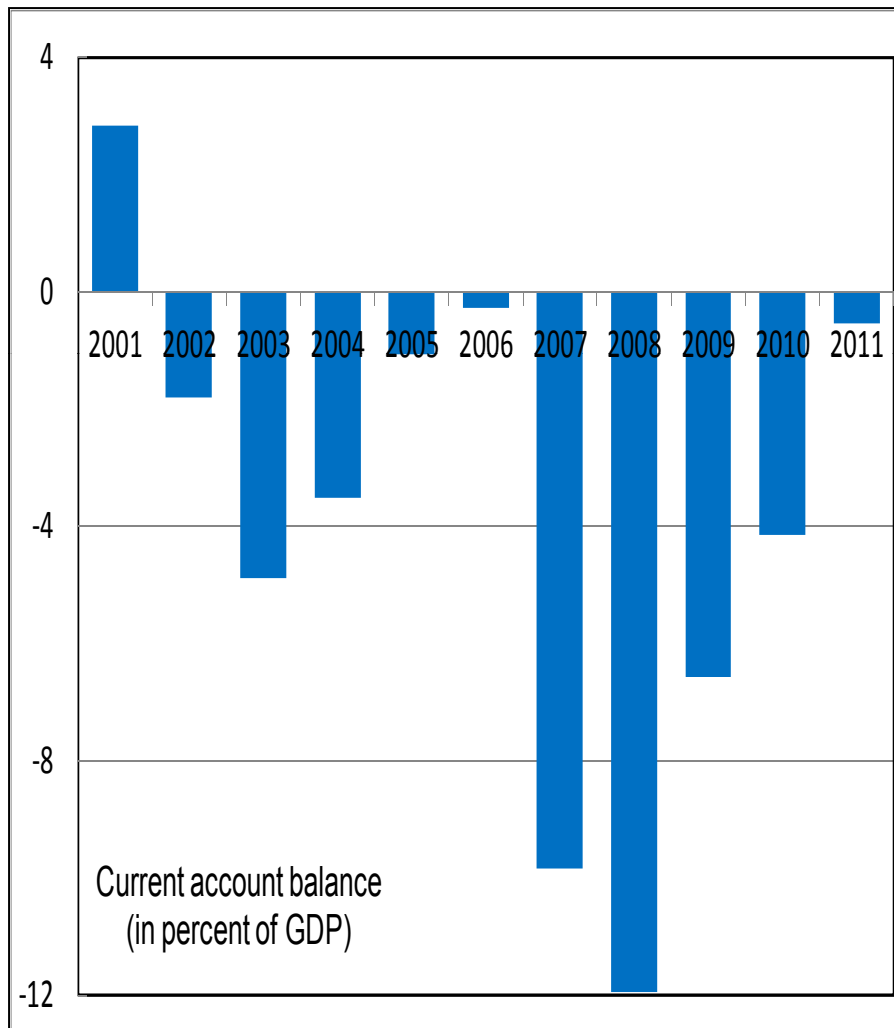
Growth and Inflation



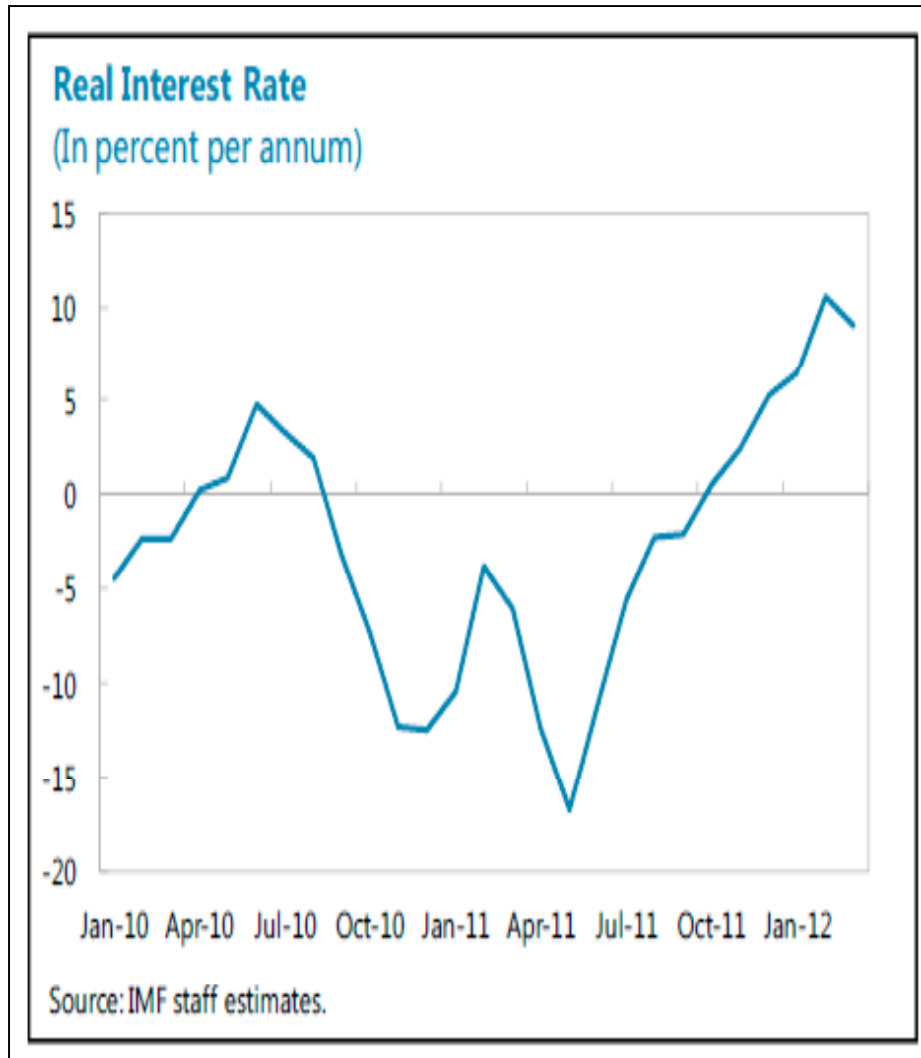
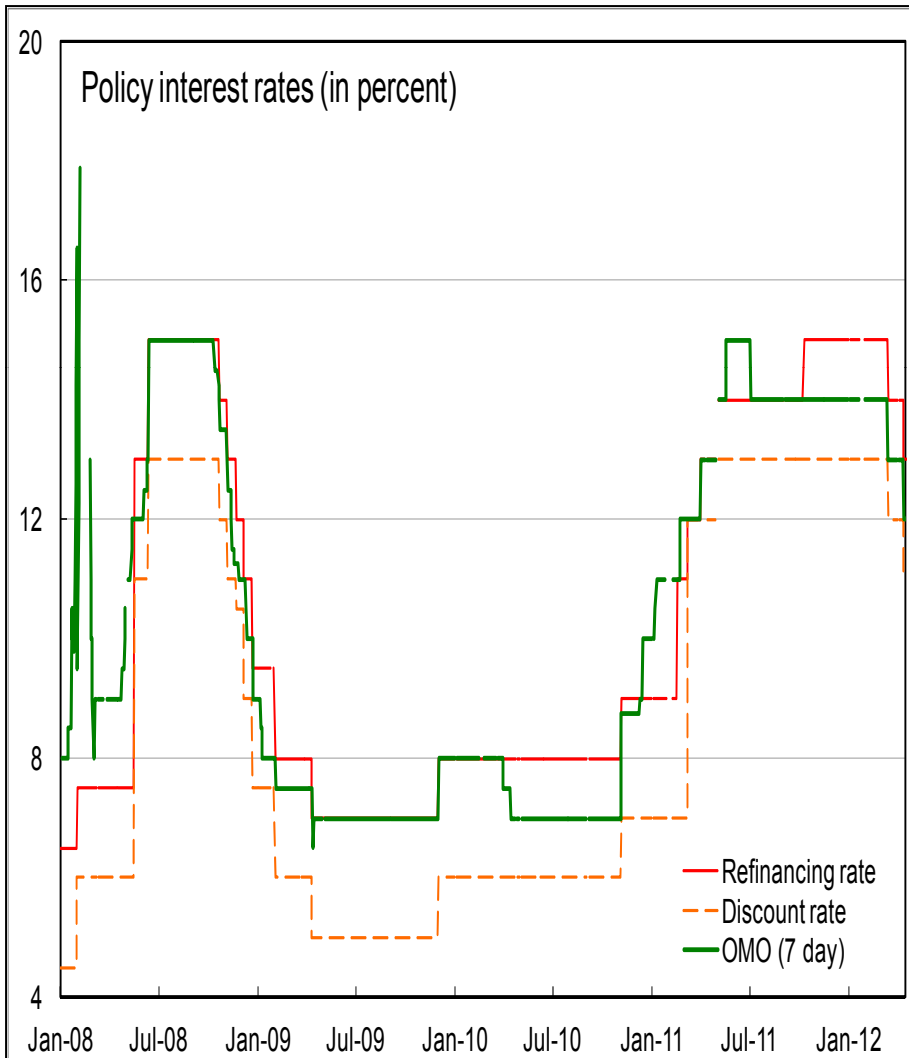
Growth and Inflation: Tradeoff



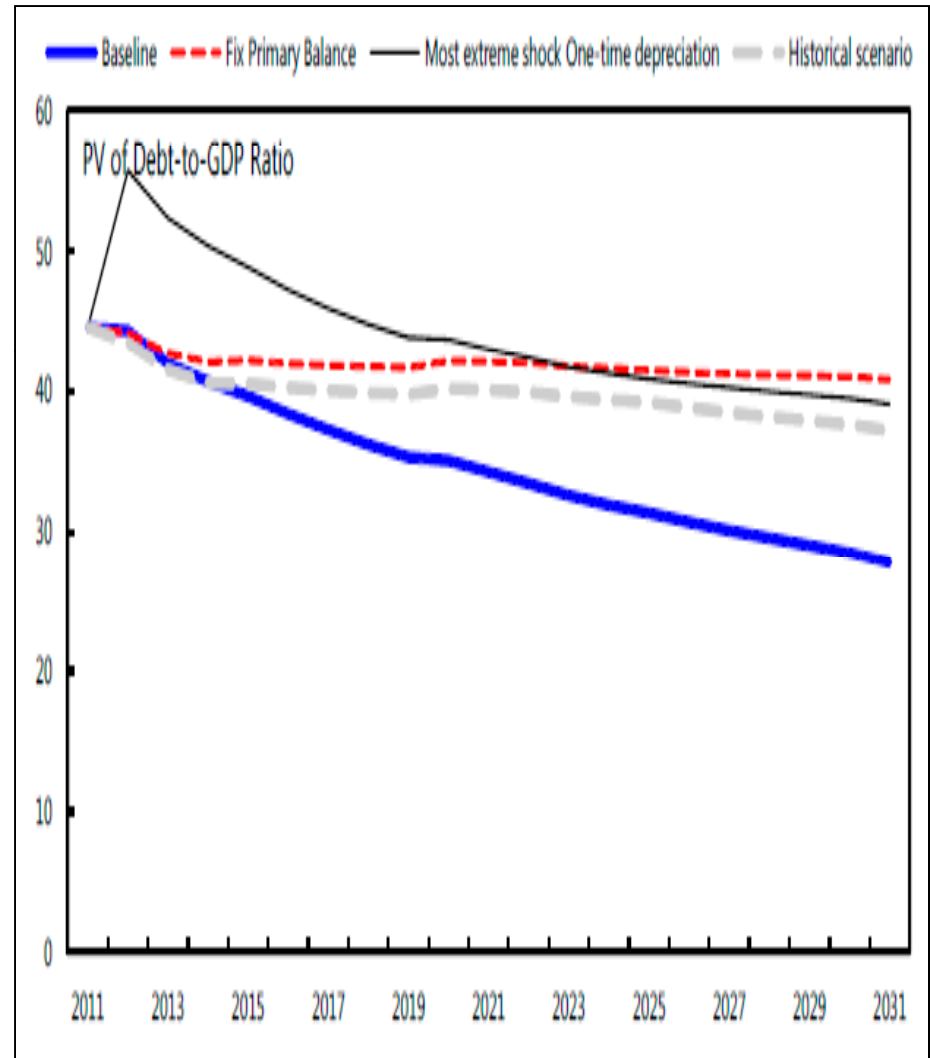
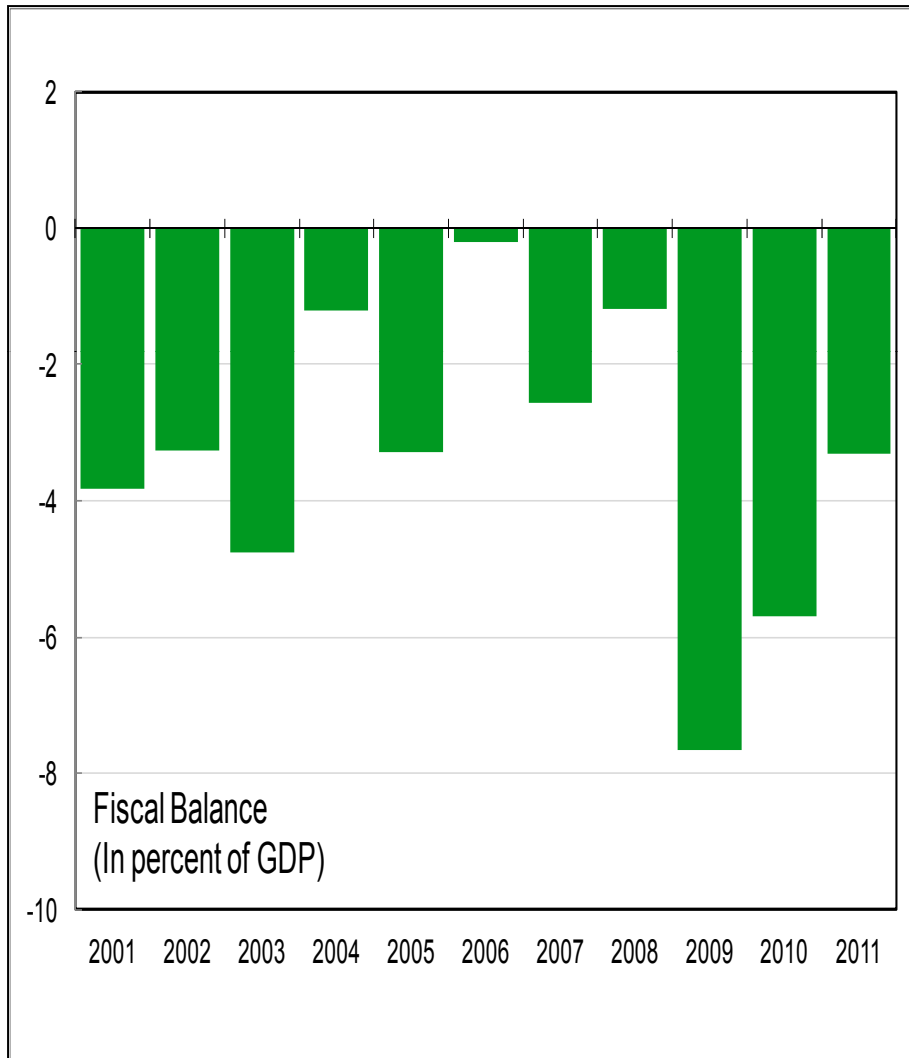
Balance of payments and International reserves



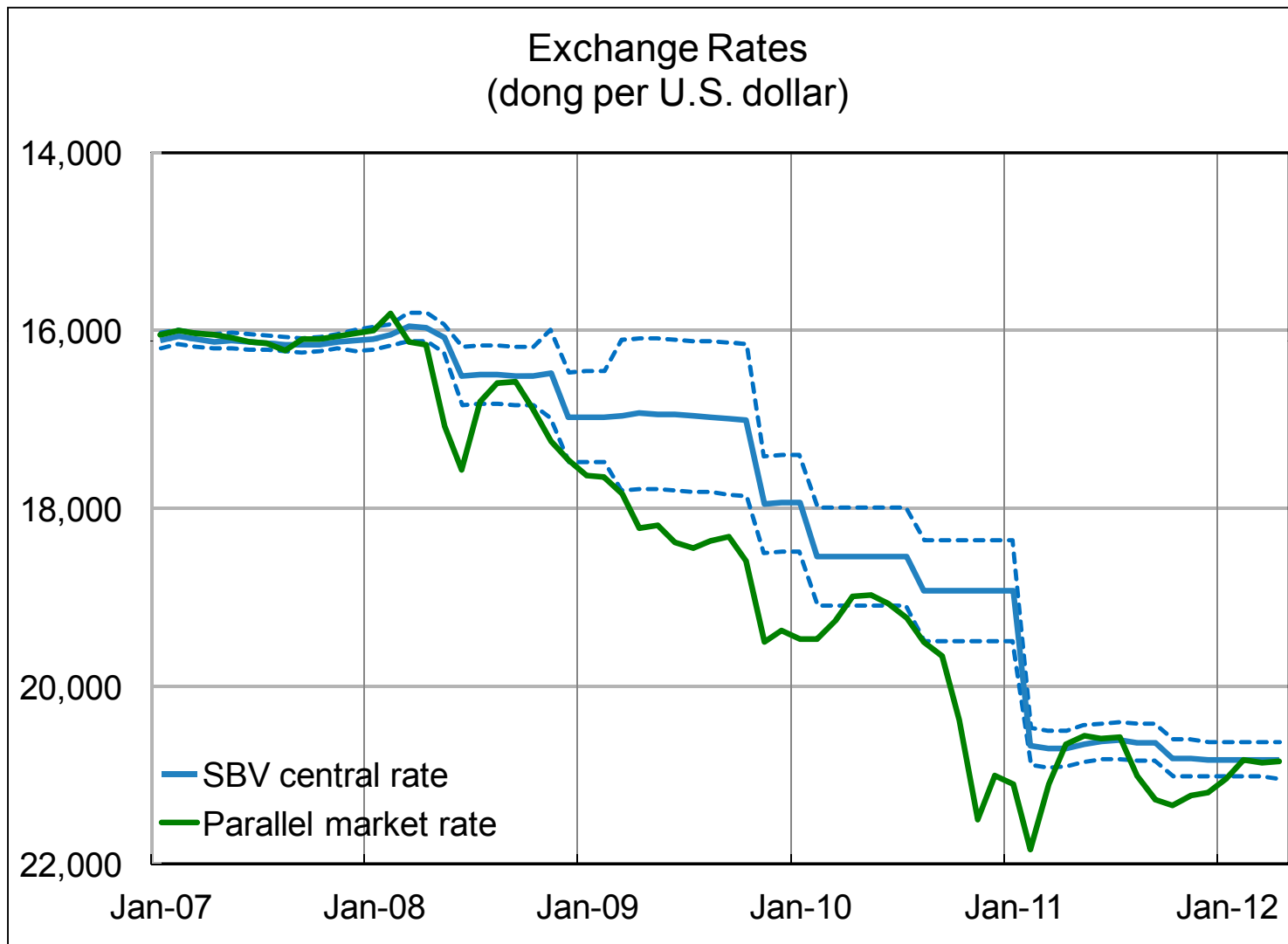
Macroeconomic policies: SBV policy rates



Macroeconomic policies: Fiscal deficits and public debt



Macroeconomic policies: The dong and the dollar



Macroeconomic policies: Administrative Controls



- Credit growth targets
- Deposit interest rate cap
- Asset markets
 - FX market
 - Gold market
- “Macroprudential” measures
 - Sectoral credit allocation and lending rates for “priority” sectors
 - Limits on real estate lending
- Loan restructuring guidelines

The past and the present



- Banking system in Vietnam—overbanked, but underbanked
- Credit: Rapid growth ... and the hangover
- Macrofinancial linkages



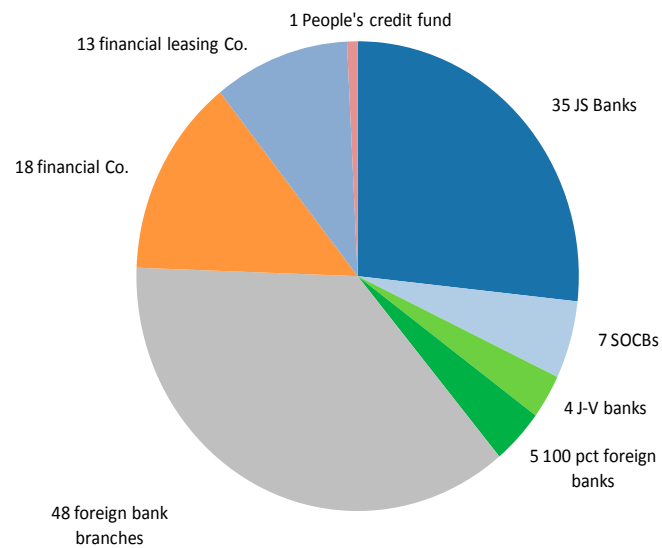
Banking system in Vietnam: Overbanked, but underbanked



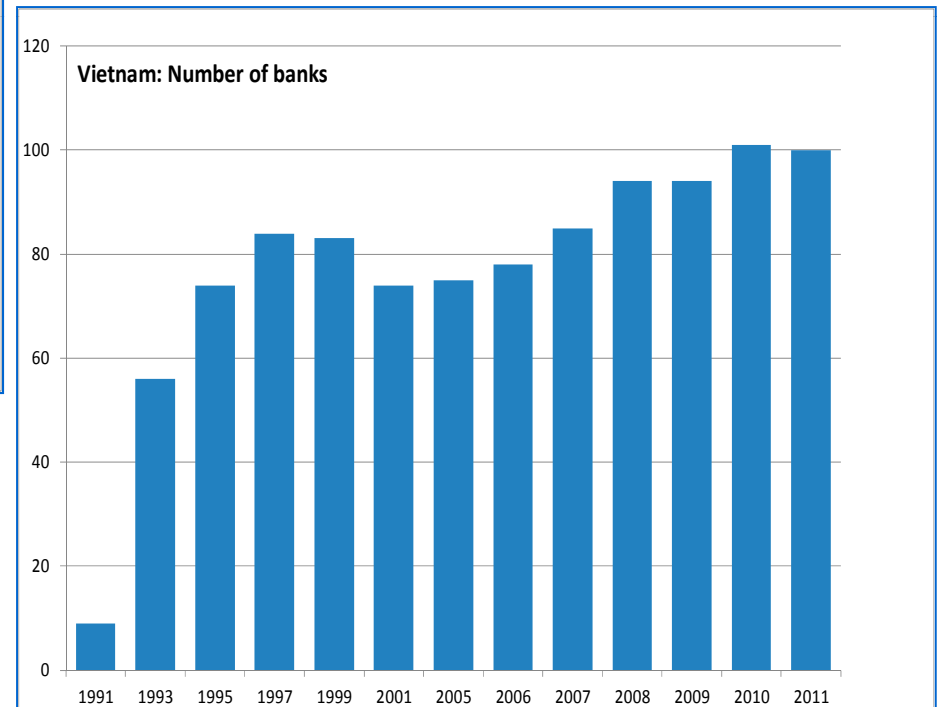
Crowded financial and banking system ...



Vietnam: Financial System Structure, 2011



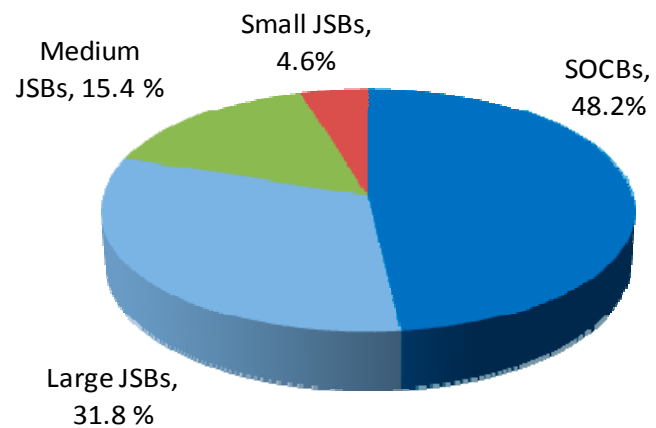
Source: SBV



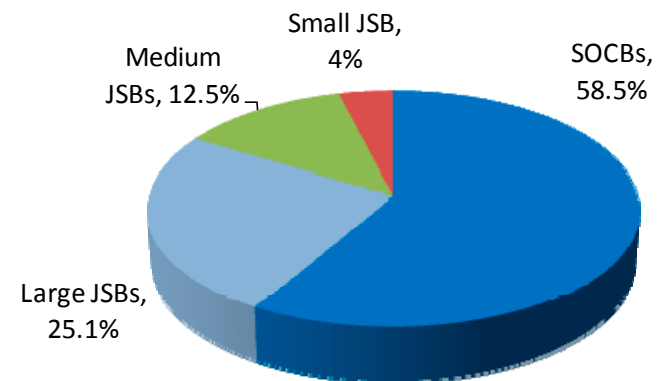
... dominated by 5 large SOCBs



Banks' market share by asset, 2010
(In percent)

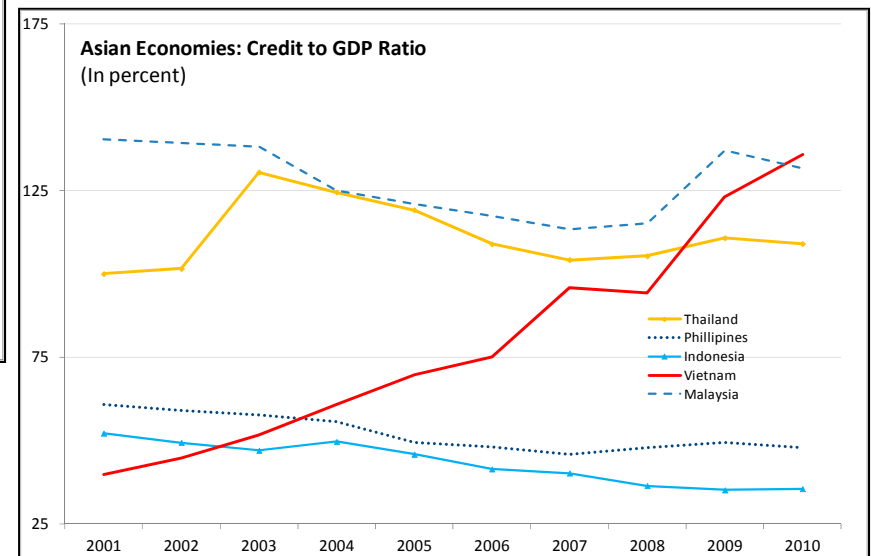
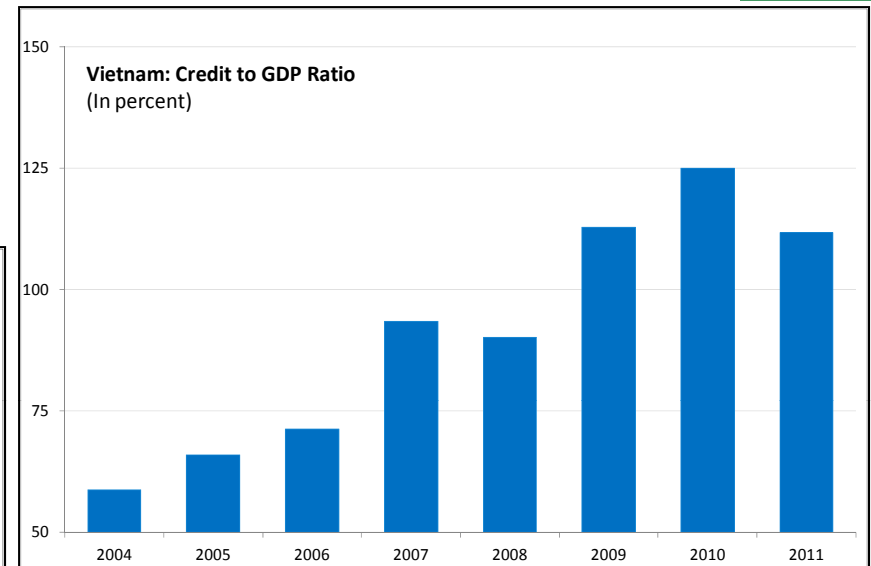
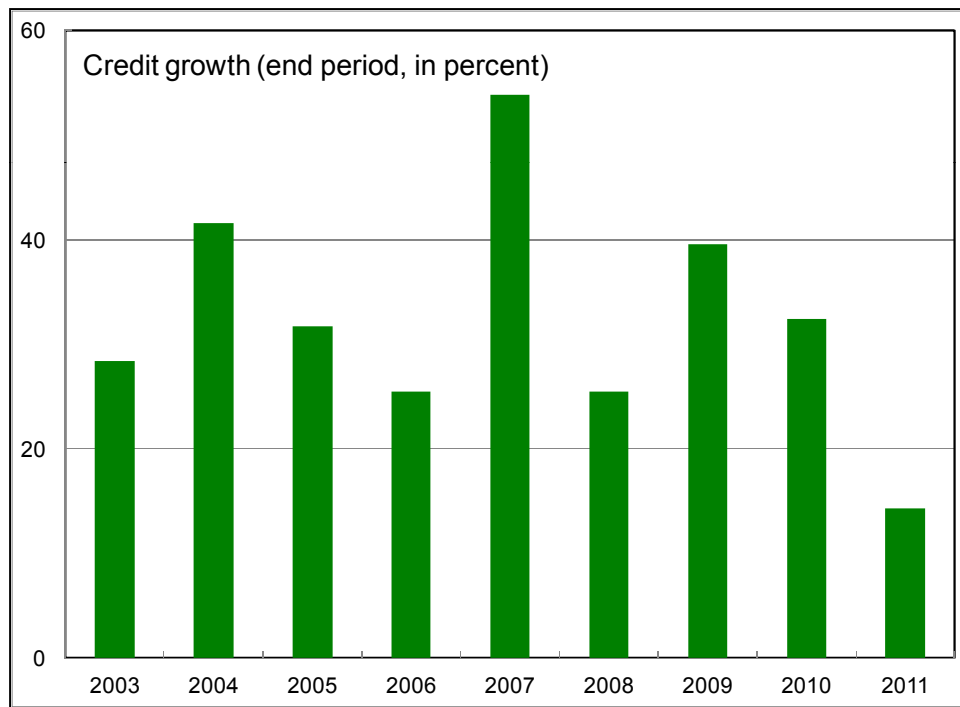


Banks' market share by credit, 2010
(In percent)



Note: Large-sized JSBs: assets over VND 60 trillion; Medium-sized: assets over VND 50 trillion; Small-sized: assets over VND 20 trillions
Sources: SBV, and Fund staff calculations.

Credit: Rapid growth ...

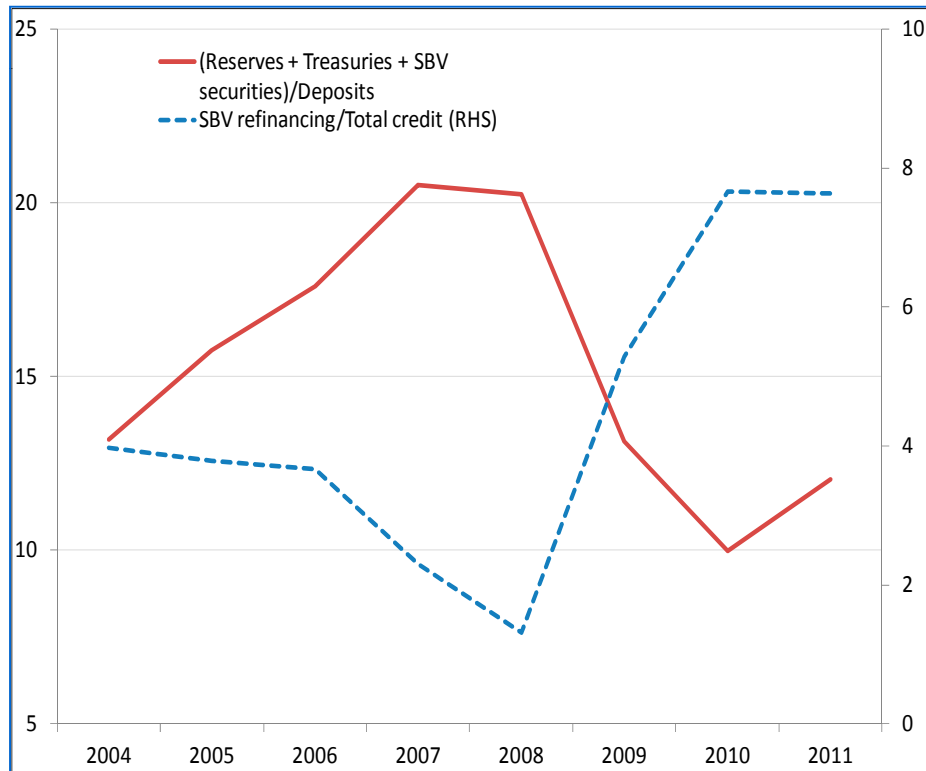




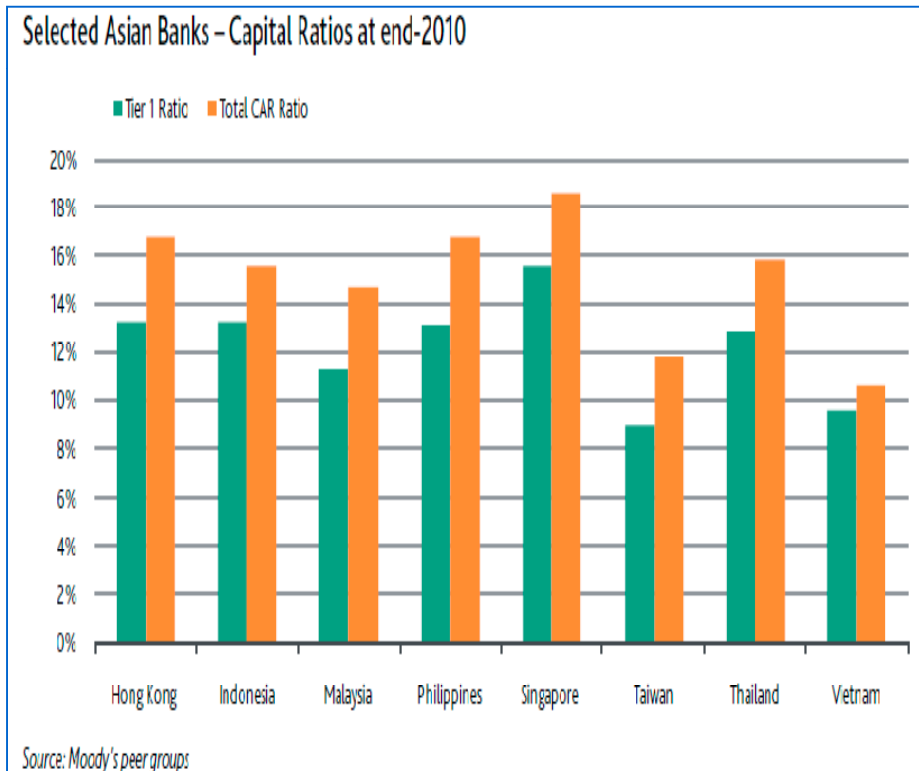
... and the hangover

- Liquidity problems in weak banks
- Solvency: Low capital adequacy/banks have limited buffers; banks' NPLs—low by VAS, but much higher by IAS/IFRS; exposure to Vinashin/financially weak SOEs unknown
- Unsustainable business models: Growth expectations; RE prices; Noncore/other businesses

Liquidity stress



Capital adequacy



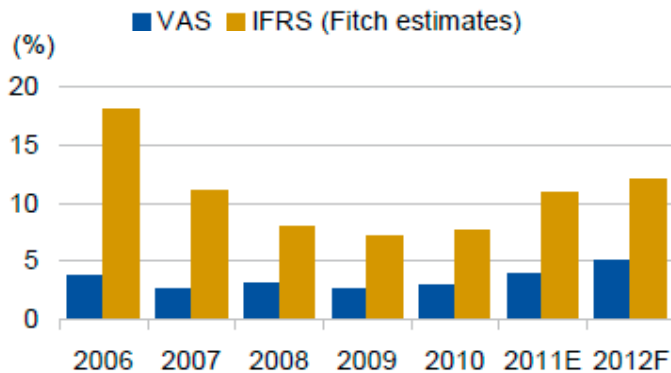
Sources: SBV, and Fund staff calculations.

NPLs—size/credibility



Vietnam: Key Performance Trends

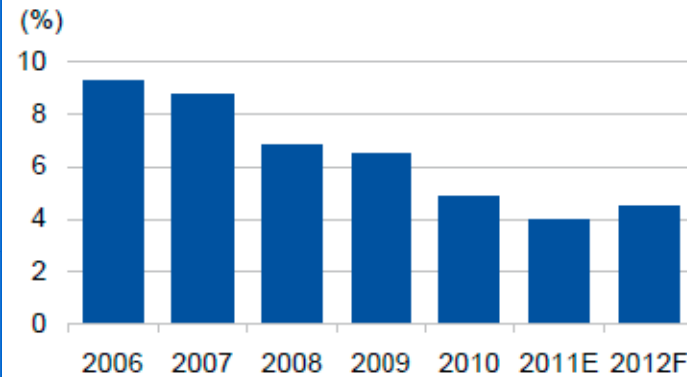
Asset Quality - NPL ratio



Source: Fitch, banks

Thailand: Key Performance Trends

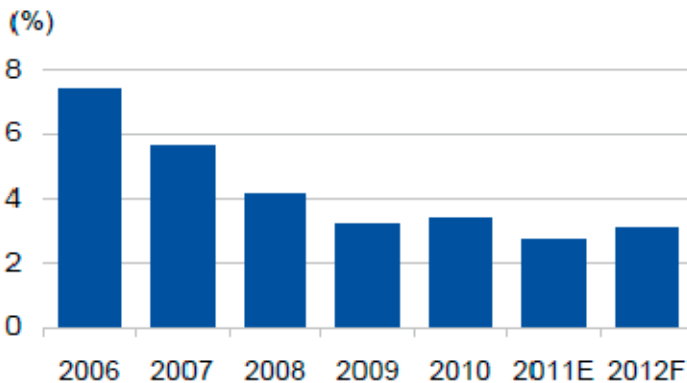
Asset quality - NPL ratio



Source: Fitch, banks

Malaysia: Key Performance Trends

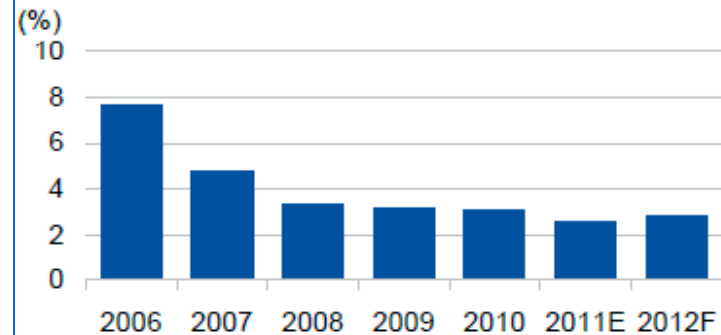
Asset quality - NPL ratio



Source: Fitch, BNM

Indonesia: Key Performance Trends

Asset quality - NPL ratio



Source: Fitch, 9 major banks



The Future: A Framework for Monetary and Exchange Rate Stability

Monetary Stability: Objectives and Goals

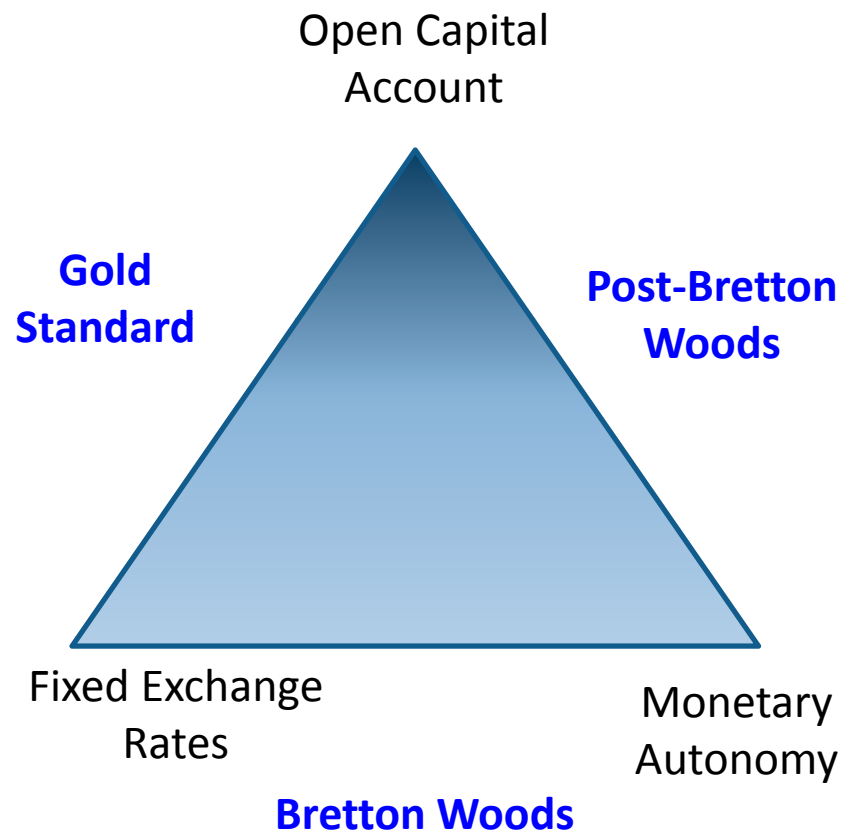


- Internal balance
 - ✓ Low, stable inflation
 - ✓ Sustainable, high growth rate
- External balance
 - ✓ Sustainable current account deficits
 - ✓ Stable capital flows
 - ✓ Build international reserves

The Monetary Policy Framework: Theory



- The Mundell-Fleming open economy trilemma
- The trilemma is not a watertight constraint, but ensuring macroeconomic policy consistency is important, even as central banks pursue multiple objectives with multiple instruments.
- Pragmatism does not mean losing sight of some of the basic tenets of macroeconomic policy



Source: S. Y. Liew, Monetary Authority of Singapore.

The Monetary Policy Framework: Practice



- Restrictions on foreign capital movement, but residents shift between the dong, USD, gold, and other assets. Vietnam approximates a small open economy with free capital mobility. If so, constraints of the trilemma largely apply
- Policy implication—interest rates, credit growth and exchange rate targets cannot be pursued simultaneously. Attempts to fix both interest rates and exchange rates with capital mobility can result in capital inflows which overwhelm the system
- Purist approach unlikely to work → reliance on range of policy tools and instruments—interest rates, quantitative credit restrictions, reserve requirements, macro-prudential policy tools
- Practical approach must be underpinned by sound economic principles/consistent macroeconomic policies
- Increasingly, macro-prudential tools seen as useful complement to standard monetary policy in EMEs, e.g., Singapore, HKSAR, Indonesia, in dealing with capital inflows and asset price inflation pressures

Source: S. Y. Liew, Monetary Authority of Singapore.

The Monetary Transmission Mechanism in Vietnam



- Monetary policy transmission complicated by
 - ✓ Transition: rapid changes in the economy and financial system
 - ✓ Partial dollarization and asset substitution—dong, dollar, and gold
- Analytical literature—Determinants of inflation
 - ✓ Food and fuel prices
 - ✓ Second-round effects
 - ✓ Exchange rate
 - ✓ Macroeconomic policies
 - ✓ Supply shocks
 - ✓ Expectations

The Monetary Policy Framework in Vietnam: Recommendations



- Near term
 - ✓ Exit from administrative controls
 - ✓ Clearly specify simple monetary policy objective, anchors, and tools
 - ✓ Supportive and coordinated fiscal policy
 - ✓ Banking sector stability—address confidence and liquidity problems

The Monetary Policy Framework in Vietnam: Recommendations



- Medium and long term
 - ✓ Monetary and Exchange Rate system
 - Stable and predictable monetary policy
 - Confidence in the dong and exchange rate flexibility
 - Market determined exchange rate
 - Enhance indirect, market-based instruments of monetary control
 - Improve the monetary transmission mechanism
 - Further develop money, interbank and other markets
 - Sustainable levels of public debt
 - ✓ Structural reforms
 - Banking sector
 - State-owned enterprises
 - Public investment
 - Capital markets

Banking System: Objectives and Goals



Immediate/Short-term

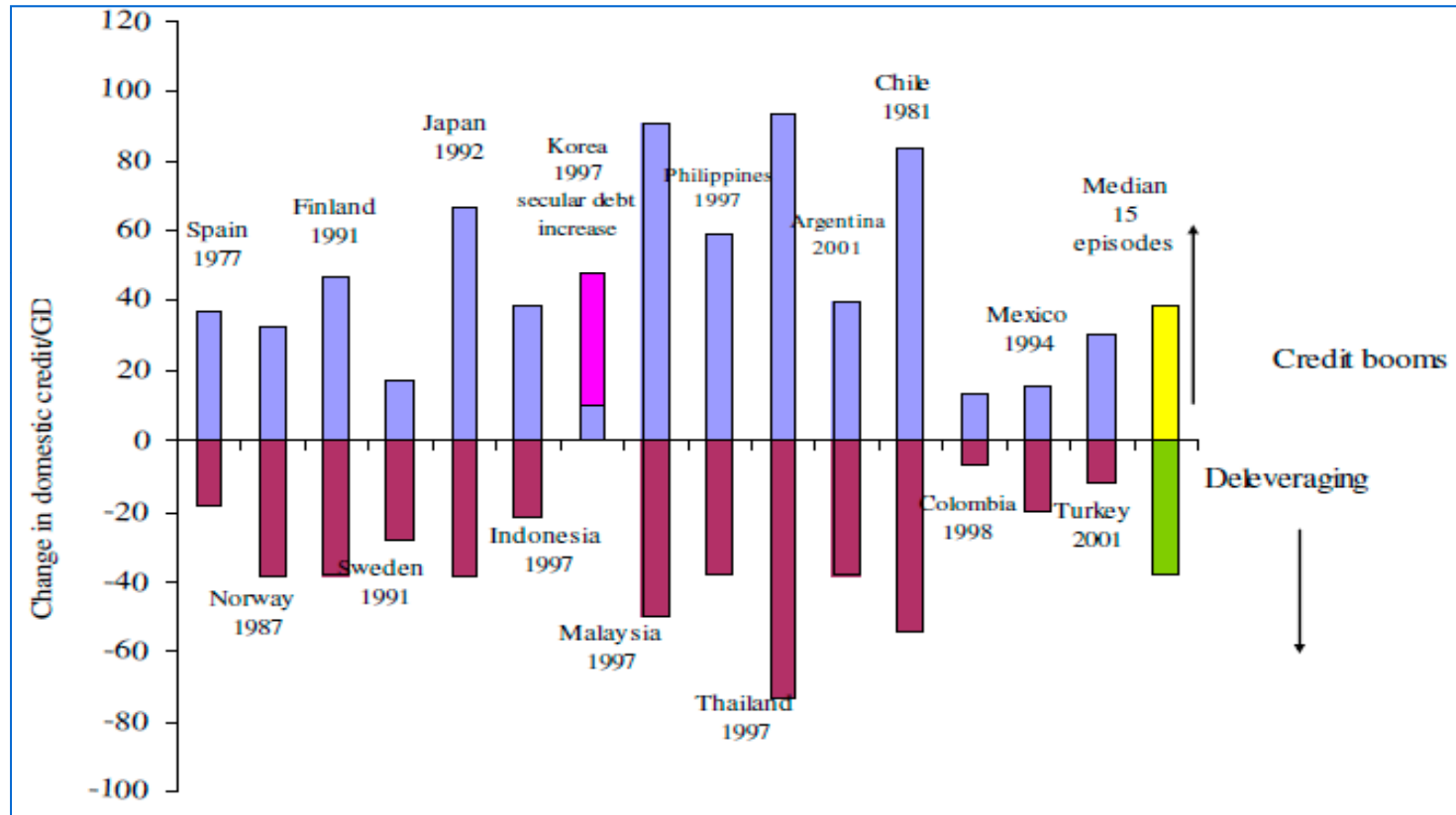
- Banking system stability → Solvency, liquidity and effective financial intermediation
- Timely intervention → Prevent contagion or systemic concerns
- Confidence in banking system → Prevent deposit runs

Longer-term/Structural

- Address solvency problems
- New governance framework
 - preserve/create incentives for
 - ✓ new private capital
 - ✓ bank discipline in lending
 - allocate first losses to shareholders
- Only viable/sustainable banks should remain → Improve operational efficiency
- Build competition and resilience
- Strengthen overall infrastructure of financial system
- Improve access to financial services

Sources: S. Goyal 2012 (WB) and L. Taylor 2012 (SCB).

Deleveraging



Amplitude of Boom-Bust Credit Cycles (10 yrs before and after)

Sources: Rogoff and Reinhart (2010).

Weak credit growth

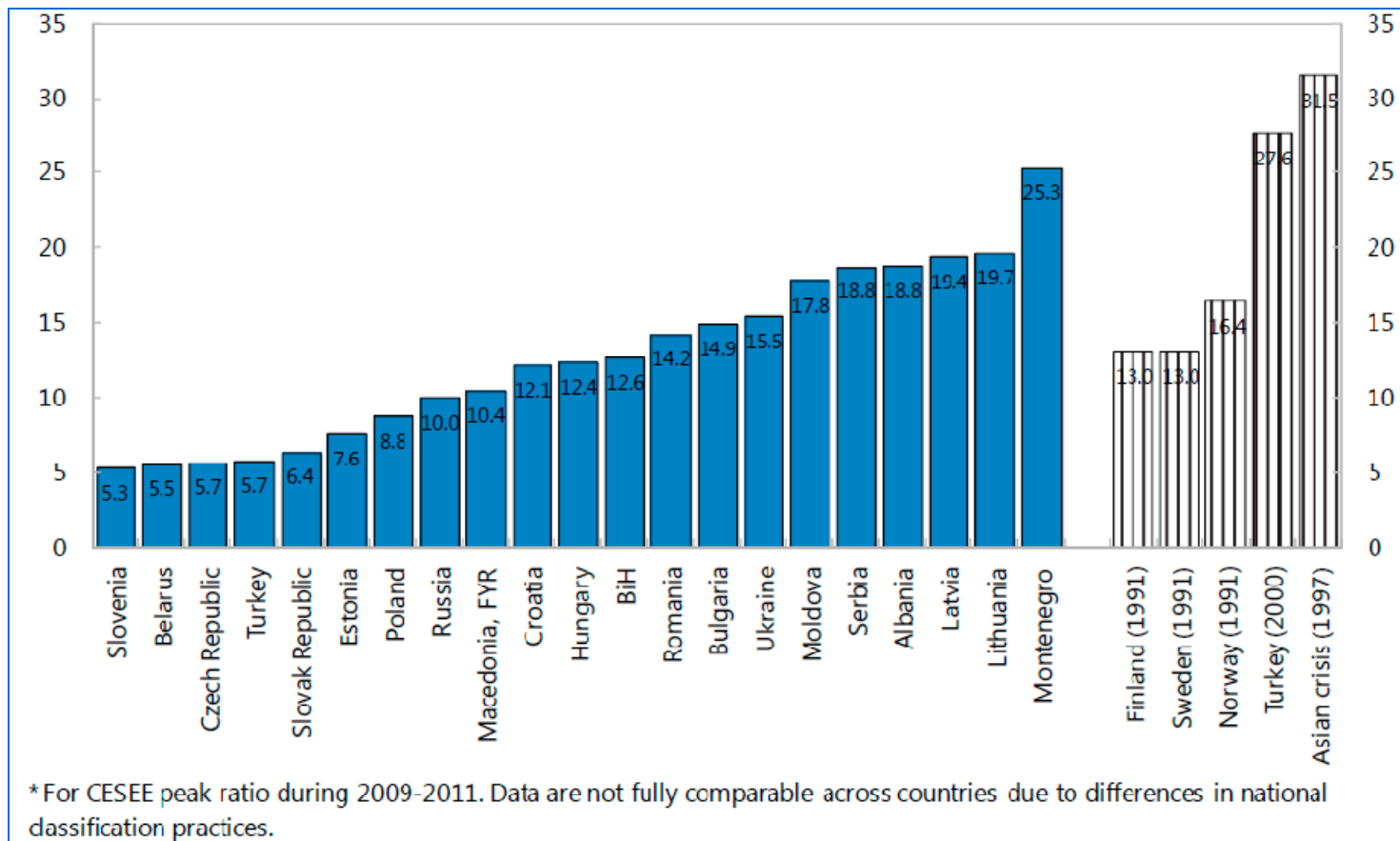


Channels

- Supply
 - Higher funding costs
 - Higher interest margins
 - Lower capitalization
- Demand
 - Overextended borrowers have lower credit demand



Peak NPLs

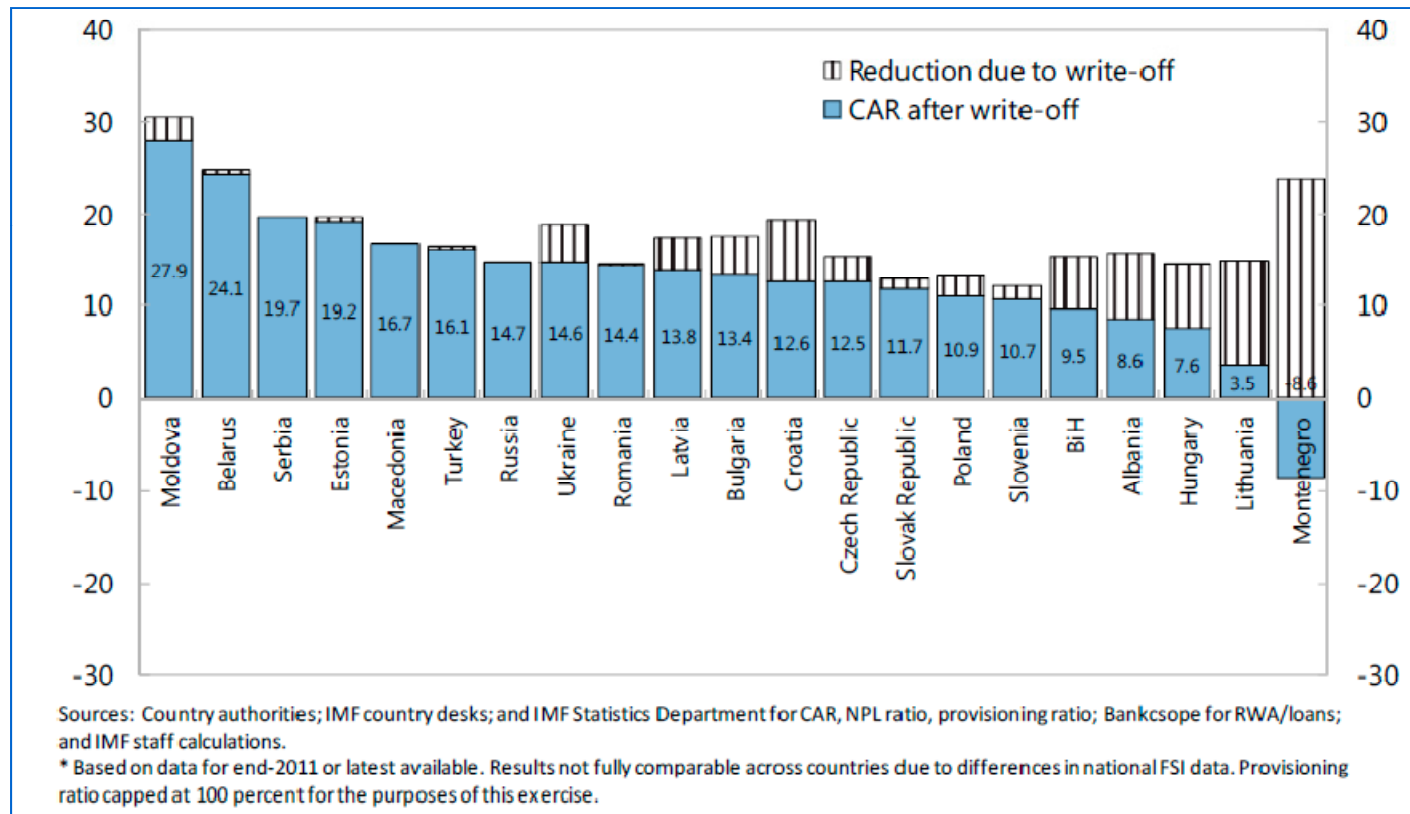


Sources: Working Group on NPLs in Central, Eastern and Southeastern Europe, March 2012.

Lower capital adequacy

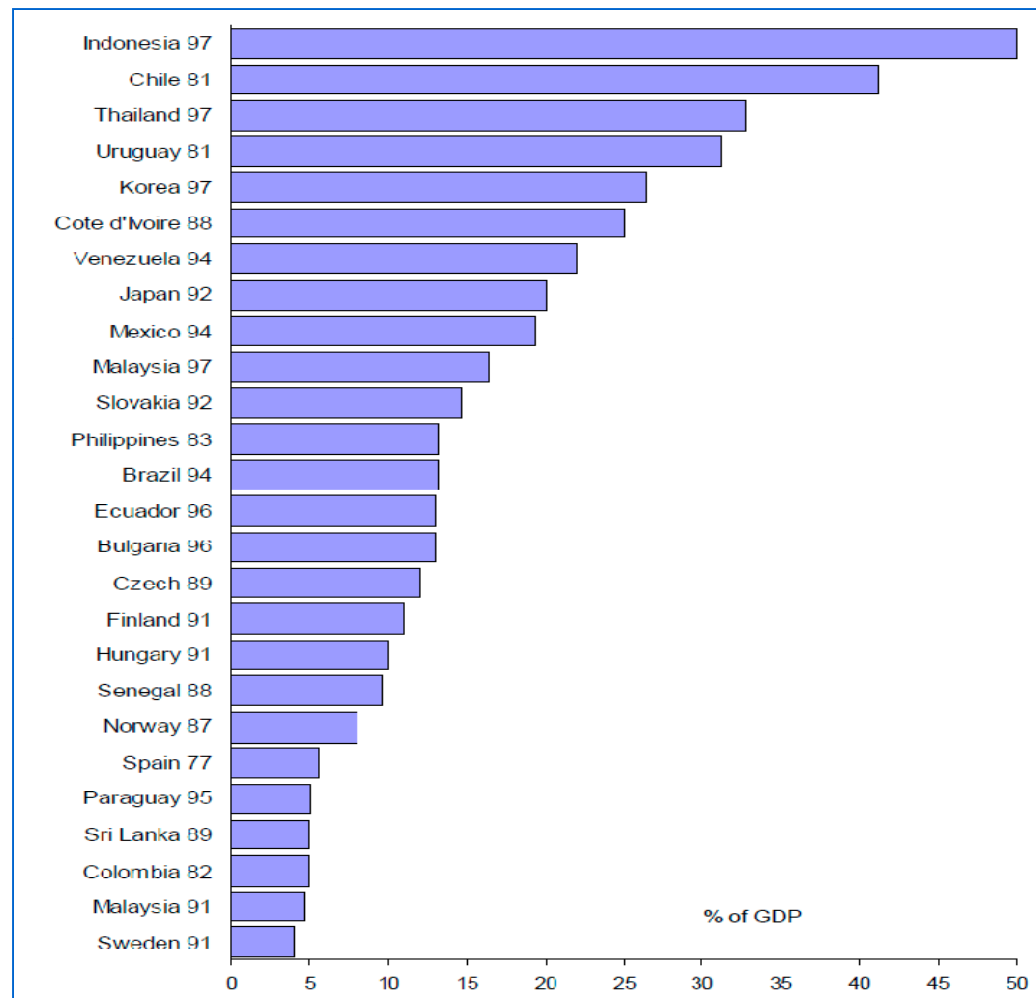


CESEE: CAR Under Complete Write-off of Existing NPLs (in percent of RWA)



Sources: Working Group on NPLs in Central, Eastern and Southeastern Europe, March 2012.

Fiscal Cost of Bank Restructuring



Source: Honahan and Klingebiel (2000).



Thank you