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Financial Turbulences in Vietnam's Emerging Economy: Transformation Over 1991-2008 period

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Summary

This study focuses on substantial changes that characterize the shift of Vietnam's macroeconomic structures and evolution of micro-structural interaction over an important period of 1991-2008. The results show that these events are completely distinct in terms of (i) Economic nature; (ii) Scale and depth of changes; (iii) Start and end results; and, (iv) Requirement for macroeconomic decisions. The study rejected a suspicion of similarity between the contagion of financial crisis in 1997-98 and economic chaos in the first half of 2008 (starting late 2007). The depth, economic settings of, and interconnection between macro choices and micro decisions have all grown up significantly, partly due to a deeper level of integration of Vietnam into the world's economy. On the one hand, this phenomenon gives rise to efficiency of macro level policies because the consideration of micro-structural factors within the framework has definitely become increasingly critical. On the other hand, this is a unique opportunity for the macroeconomic mechanism of Vietnam to improve vastly, given the context in which the national economy entered an ever-changing period under pressures of globalization and re-integration. The authors hope to also open up paths for further empirical verifications and to stress on the fact that macro policies will have, from now on, to be decided in line with changing micro-settings, which specify a market economy and decide the degree of success of any macroeconomic choices.

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Introduction

In its evolution, the economy experienced a turbulence time as starting-point of a new development phase. Vietnam's economic adverse change in 1997-1998 was affected by the spillover from East Asian financial crisis.[i] A decade later, period 2007-2008, economic changes occurred at the same time of the global credit crisis. Stemming from the United States, the home sub-prime mortgage quickly affected the international financial system. Economic downturns were inevitable. It is worthy to understand its nature, cause and development, and consequences for lessons and future cautions. The authors choose this approach to be the focus of the study.

Entering 2007, the Vietnamese economy carried with it positive signals from the burgeoning 2006. On January 11, 2007, Vietnam became the 150th member of the World Trade Organization. The nation's stock market celebrated the seventh anniversary in an ever growing trend starting in mid 2006. On March 12, 2007, Vn-Index reached its all-time record of 1,171. Registered FDI in 2006 was US$10.2bln – the highest since 1988 – doubling those of the previous year. The economy expanded 8.17% in 2006, well above the average 7.51% of period 2001-2005.

The seeds of abnormality sprouted in February 2007 when growth indexes of equity and money markets misinterpreted the economy's real capability (Vuong, 2007a). In the following months, signals became clearer, especially on stock markets. Total market capitalization went up to 30% of GDP, mainly due to the boom in financial asset prices. Meanwhile, many fundamental concepts of stock markets were seriously over-looked even ignored by individual investors. Financial information was poor with almost no transparency in place. Investor relations only become hot spot when stocks began to slump, although it was still grouped with PR and advertising activities (Vuong, 2007b). Corporate governance and conflict of interest in public firms have been unfamiliar with the majority of market players. "Money" mobilized through capital markets were extravagantly and ineffectively used in expansion plans and green-field projects – mostly in real estate, and banking and finance. Fast growth was doubtless supported by a rampant rent-seeking process over the nascent economy.

The economy started facing massive challenges at the beginning of 2008. Stock markets slumped with its VN-Index retreating to 366 (on June 20, 2008), a comparable level of March 2006. Cumulated inflation in the first 3 months surpassed 9% and reached 15% in May. Businesses had tough time when oil and commodities surged, and lending cost hiked to a phenomenal 21% per annum (p.a.). Costs cutting and employment reduction were common. Commercial banks had their own troubles with liquidity. Saving interest rates increased to as much as 20% p.a. The central bank has increased primary rate to 14%p.a. in June. Fluctuation limit of foreign exchange was widened by ±2%. Meanwhile, official exchange rate was adjusted to deal with increasing free market rate of up to VND 20,000 for 1 US dollar. Trade deficit mounted to US$ 14 bln. in the first half of 2008.

Those scenarios stoke concerns and analyses over the possibility of a financial crisis in Vietnam in the manner of East Asia financial crisis. Nevertheless, it is necessary to have an in-depth look at macro scenarios while taking consideration of regional and global situation together with economic mechanism of the country.

The purpose of this study is to make comparisons and qualitative analyses of economic features over sub-periods of 1991-92, 1997-98, and 2007-98. There are major distinctions in fundamental criteria of growth, inflation, monetary policy, financial markets, and foreign investment. The story in Thailand and East Asia in 1997 is unlikely to happen in Vietnam. The study also suggests continuous research on effect between macro policies and micro implementation, roles of business culture and communications in tough times.

1. An overview of Vietnam's economy in reform

Since the nation's re-unification in 1975, the per capita GDP has been triple. From 1975 to 1986, the curve (in Figure 1) slightly went up by 1% p.a. It started taking off in 1988, two years after the implementation of Doi Moi economic policies. The transition process from a central planning to market oriented economy made Vietnamese people happy. In the five years of 1987-1991, per capita GDP grew 3% annually, on average. After that, economic growth sped up to approximately 6-7% p.a. in nearly two decades.

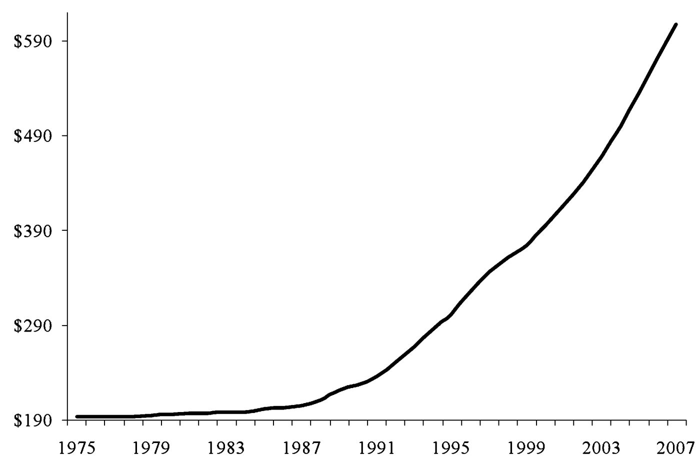

Figure 1. GDP per capita * Source: DHVP

The Vietnamese economy remained stable through out most of the 1990s. GDP growth rate ranged from 8-9%, except the last years when the Asian crisis worsened the regional economy. The recovery process took about four years. Economic growth was 6.5% in 2004 again. This expansion continued till present. Although growth expectation of 2008 was reduced from 9% to 6.5% because of economic difficulties, the nation still saw a 6.1% of GDP growth, in the first half.

The introduction of the Law on Foreign Investment in 1987 was a milestone in Vietnam's reforming path. The Law encouraged and legitimized the foreign direct investments (FDI) into Vietnam. Since 1988, FDI has become a major driving economic force (World Bank, 1998). The relative importance of FDI inflows to Vietnam's economy has so far been profound. FDIs brought up the productive capacity of the economy, and generated new income sources. Although Asian financial crisis impeded development of FDIs until 2004, the registered FDI to Vietnam kept increasing regardless the decrease of numbers of project during the period 1997-2005. On the other hand, higher level of income and GDP pulled along levels of consumptions and reinvestments, whose impacts encouraged foreign investors that seeked to expand markets and growth-oriented opportunities.

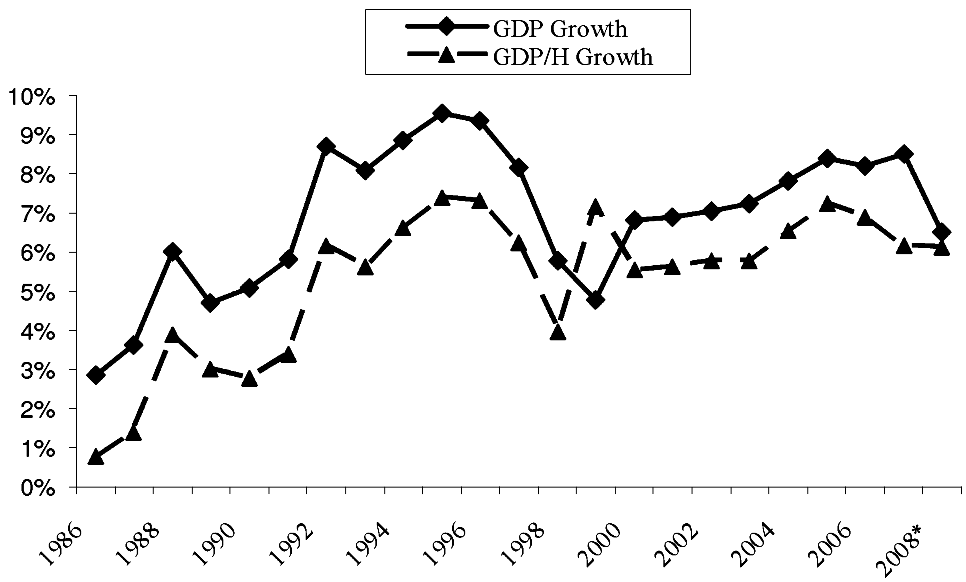

Figure 2. Doi Moi 1986- A period of genuine growth - Source: DHVP

Consequently, international capital to Vietnam, following the path of FDI, flows to banking and financial industries. Within 1992-97, 24 foreign bank branches and five joint-venture banks were established. These foreign-invested banking operations became operational in the major urban economic hubs, namely Hanoi and Ho Chi Minh city, and have gradually grown up to be major players in the financial sector of Vietnam. The financial market is thus given more attention as an overall solution.

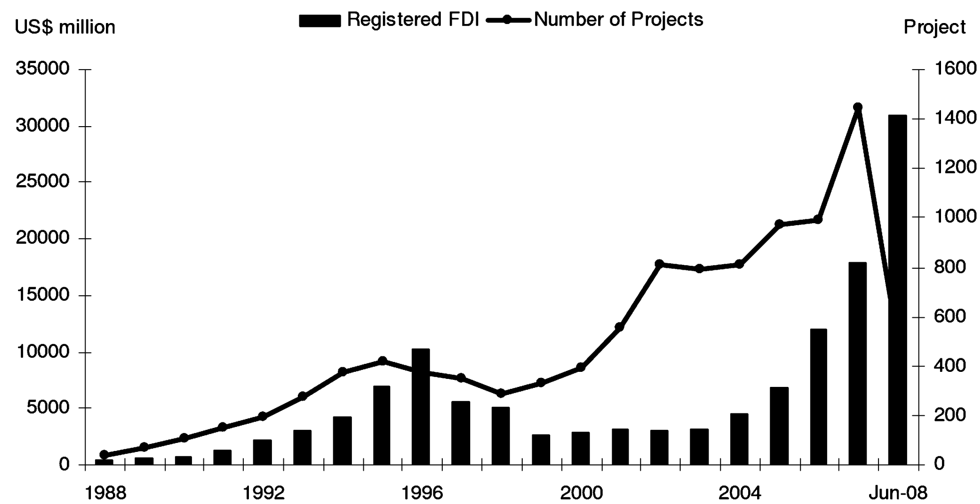

Figure 3. Foreign Direct Investment: 1988-2008 * Source: Ministry of Planning and Investment

2. Problems arising in the 1988-2008 period

Priorities of macro economics issues in Vietnam were poverty reduction and competitiveness improvement, in 1990s. After a decade, people's living standards improved significantly, and the integration process has been implemented comprehensively. Facing economic challenges, new focuses became: sustainable development and inflation control. The stability of financial system consisting of stock and money markets, and capital flows was a key concern.

Growth and Inflation

In the later half of 20th century, relation between growth and inflation felt into two cases. Rapid growth and low inflation were in 1960s; and, rapid growth and high inflation in 1980s. In 1960s, classical theories, which state that inflation slows growth, became unconvincing with the popularity of Phillips curve. Alban Phillips statistically approved that in period of low unemployment, inflation rate also was low and vice versa. In other words, economic growth is proportional to inflation rate. Tobin and Sidrausky even proposed the existence of this relationship in long-run. When inflation is high, assets will not be stored in form of currencies, instead it is used to buy other physical assets; therefore, social productivity tends to heighten.

Experimental researches in OECD economies, however, did not entirely support those views (Harry G. Johnson, 1967). IMF studied its members and concluded that there is no specified relationship between economic growth and inflation rate statistically. In 1969, Wallich conducted a field study in 43 countries, looking at economic data of 10 years from 1956-1965 with presumption that inflation and growth were proportional. The result was quite striking. Statistically, there was negative relation between growth and inflation.

The 1970s and 1980s economic turbulence recorded a high inflation. Observers in this period concluded that high–but-stable inflation rates do not significantly affect productivity. A popular view in 1980s was a short-run proportional relationship between inflation and economic expansion. The facts of developing countries reinforced the argument that inflation-curbing measures impede growth. Ball's study (1993) constructed figures showing lower speed of OECD nations in an effort to stabilize prices. Inflation when crossing a threshold limit value will accelerate. Then, no economic system can sustain turbulent prices. Thus, stabilizing measures must be introduced and implemented aggressively. As a result, high inflation cannot insist for long time. On the other hand, study by Dornbusch and Fishcher (1993) concluded that medium rate ranging from 15 – 30% is acceptable for quite long time without causing negative impacts on the economy.

There are not many studies on inflation-growth relationship in Vietnam. In May 2008, The Central Institute for Economic Management (CIEM) released Vietnam Economic Report 2007 and forecast 3 scenarios for 2008. In April, Asian Development Bank also predicted the growth rate and inflation of 2008. The World Bank, IMF, JETRO… also have their own forecasts and confidence about Vietnam's potential growth in the long run. These considerations however did not place the focus on the relationship between growth and inflation.

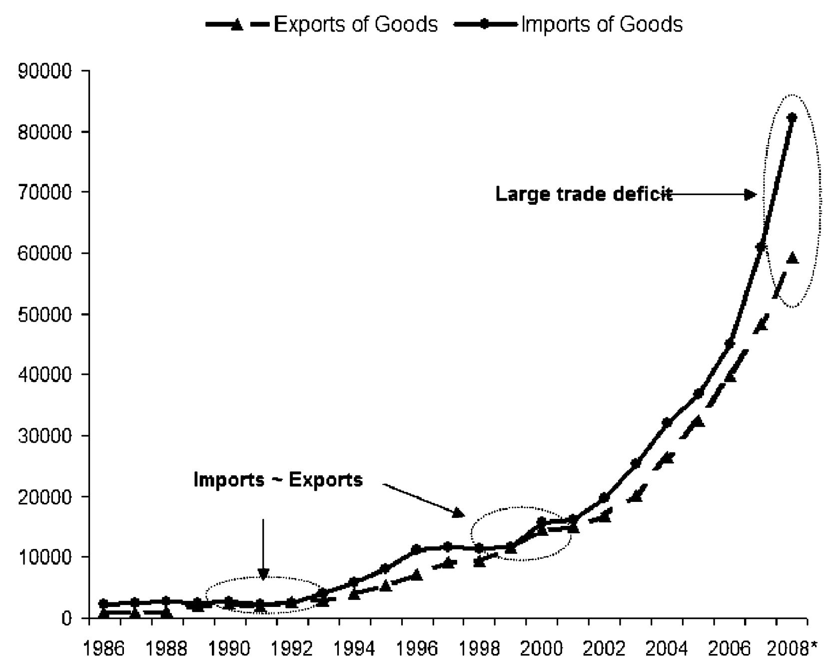

Figure 4. Imports and Exports of Goods, 1986-2008 * Source: General Statistics Office. Unit: million US$

In early 1990s, high rate of inflation was accepted as a result of the transition into market economy in Vietnam. With government spending and credit contracting, inflation slowed down remarkably in late 1990s while growth remained. Vietnam gained high economic growth – average 9% p.a.– in period 1992-1997. The main driver of expansion was industrial investment and development, which was supported by foreign investment, mounting to US$

2 bln. p.a. (5-10% of annual GDP). Nevertheless, Asian financial crisis broke the economy. Per capita GDP growth rate of 6-7% in 1990-1997 slid to 4% in 1998-1999. Regional financial difficulties limited FDI from neighboring countries. A number of large industrial projects were left uncompleted.

Since 2000, Vietnam's economic expansion rate has been steady at 7-8%. Inflation rate increased in this period, too. At the end of 2007, 2-digits inflation rate returned as in 1980s and early 1990s. Accumulated inflation exceeded 20% in June 2008. Rocketing inflation challenged Vietnamese policy makers who were set to maintain a stable growth.

As a WTO member, Vietnam liberalized trade and service activities to the rest of the world. Manufacturing and employment structures have shifted to labor-intensiveness and export orientation. The private sector has emerged. The leading role of state own enterprises now transferred to non-state players. Stock markets, commercial banks, and financial institutions brought up the national financial economy. Consequently, real income, exchange rates and interest rates became sensitive to inflation, which in turn largely affected resources allocation and overall economic efficiency. Those linkages have made the economy much more complicated than it had been one decade before.

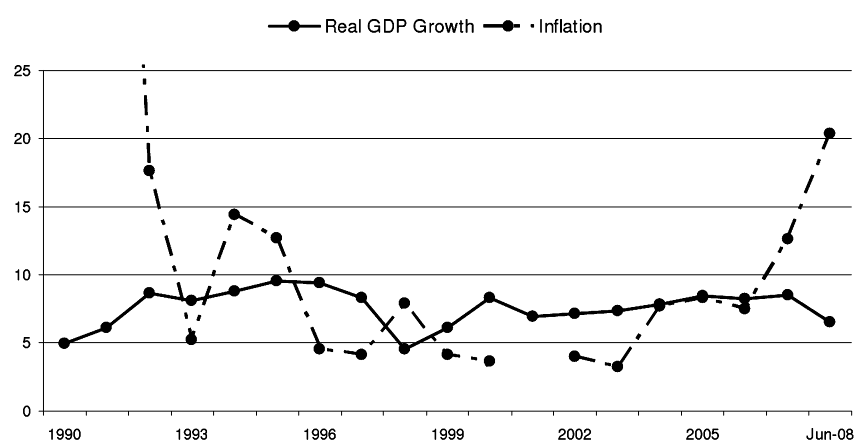

Figure 5. Real GDP Growth vs. Inflation; Unit: percent - Source: IMF

While the excessive money supply generated inflation in Vietnam, exogenous price turbulence also contributed to the surge in prices. It is useful to separate effects of money supply expansion on the demand side and those of exogenous price shock on the supply side in order to identify causes and effects of inflation. But this approach faces difficulties in obtaining reliable economic data in Vietnam.

Monetary and fiscal policies

Monetary and fiscal policies are two instruments of government in stabilizing growth in correlation with inflation (Dornbush and Fischer, 1992). Although direct objects of these two policies are commodities and asset markets, they are closely linked via macroeconomic transmission mechanism.

The influences of monetary policies on economy have two notable extremes. Liquidity trap is the situation in which the public is prepared to hold the entire money supply at a fixed level of interest rate. In this case, adjustments on open market operations have no effect on interest rates. For some reason, the rate in market is zero or the positive real interest rate is very low, so monetary policies will not work. In Vietnam, the CPI for first three months of 2008 went up 16% against the same period of 2007, while the primary rate was just 8.75%. This could probably explain why State Bank of Vietnam's movements of both injecting and withdrawing money in circulation in February and March 2008 did not affect interest rate as expected.

Table 1. CPI and Primary Interest Rate in 2008

	CPI (in comparison to same period of 2007)	**Primary interest rate** (p.a.)
First three-month of 2008	16.38%	8.75%
First six-month of 2008	20.34%	14.00%

Source: General Office of Statistics, and State Bank of Vietnam, 2008.

When interest rate lowers, investment increases. Businesses plan new projects financed by commercial banks. However, at low real interest rate, commercial banks are reluctant to provide credit, even refuse to finance. This can be a result of high level of non-performing loans accumulated in previous periods. Bernanke and Lown (1991) concluded that banks opted to refuse to provide the private sector with credit in such situation. On the other hand, it was argued that more active open market operations would lower interest rates, which in turn should make the economy move again. In other words, when rates cut have not taken full effect, it should be done more aggressively.

The money supply of an economy is illustrated by Dornbush and Fishcher as following:

$$M = \frac{1+cu}{re+cu} H = mm(i, i_D, i_R, cu, \delta)H$$

In which, mm is money multiplier, a function of interest rate (i), discounted rate (i_D), required reserve ratio (i_R), money/deposits ratio (*cu*), and rate of change in deposits (δ). Given a level of money base H, money supply depends on the so-called money multiplier. Central banks normally intervene in money supply using three main instruments: money base (H) by open market operations, discount rates, and reserve requirement. The State Bank of Vietnam (SBV) can adjust monthly primary rate and fluctuation limit.

An expansion monetary policy lifts full-employment output and raises the level of interest rate. At a given interest rate, more government spending increases aggregate demand. To meet such demand, productivity has to catch up with expectation of profit generation. Commodities market however is unable to accommodate as quick as money market; it usually takes some time to adjust output level. A distinctive effect of fiscal policies is the overwhelming of public investments as apposed to private ones, the "crowding-out" effect. Due to limit of time and data, this study is not going to make in-depth analysis of government spending and public investment efficiency.

Interest rates

Vietnam interest rate moved gradually from a centrally planned regime to a more flexibly adjusted, and systematically liberalized. Transformation in banking system took place on March 26, 1988 by separating the central bank from commercial banks establishing a de jure two-tiered system since October 1, 1990, with the Ordinance for the state bank and Ordinance for commercial banks, credit co-operatives and financial firms.

Table 2. Positive real interest rate in conjunction with Inflation: 1996-2000

	1996	1997	1998	1999	2000	6/2008 (*)
Positive interest rate	5.40	6.30	1.00	5.35	5.05	- 6.00
Positive interest rate per inflation	120	175	12	5350	6000	- 30

Source: Department of Finance and Monetary, Ministry of Planning and Investment

(*): Estimation. Unit: percent

A process of interest rate liberalization started in 1996. A mechanism consisting of a prime rate with fluctuation limit has been used since August 2000 replacing the rate ceiling mechanism applied before. The two criteria are released every month and adjusted when necessary. In case of foreign currencies lending, commercial banks and credit organizations calculated lending rates according to international market and the balance between domestic supply and demand. This is foundation for identifying a balance point of exchange rate under PPP theory, which in turn forms a self adjustment mechanism (Vuong, 2003). As of May 2001, SBV has started to provide loans in foreign currencies. Since May 2002, negotiable interest rates have been applied in credit activities.

Facing difficulties of stock markets and accelerating inflation in early 2008, SBV has tightened money supply. Since mid January, reserve requirement has increased by 1% for Vietnamese Dong and foreign currencies deposits with demand and up to twelve-month deposits. Refinanced rate doubled from January to June (15% p.a. on June 10, 2008). Discount rate was up 8.5% as at end of 2007, to 13% since June 10. In mid 2008, SBV adjusted prime rate to 14%p.a.. Credit institutions are allowed to provide loan at interest rate of up to 150% of prime rate causing the highest lending rate to 21%p.a.. It is noted that in this time, short-term rates are as high as or even higher than longer term rates.

Open market operations were conducted in two directions: both tight and ease money, but did not change the interest rates. In the third week of Feb. 2008, SBV complemented VND 33,000 bln. in circulation, however, commercial banks continued raising borrowing rates. An issuance of VND 20,300 bln. Treasury bill was announced in mid February and implemented a month later. Since interest rates kept increasing, it was really difficult to measure any effect of such withdrawal. In June 2008, borrowing rates of commercial banks headed for lending rate ceiling. Gloomy effects of open market operations in time of inflation propose a hypothesis of existence of liquidity trap in the credit system. If it is true, further increase of interest rate tools is rational solution in stabilizing currency market.

In comparison with period 1997-1998, monetary policies in 2008 have used more tools and higher intensiveness. From 1997 to 1999, in order to help businesses out of difficulties due to regional financial crisis, monetary policies were loosened with positive real interest rate. In 2008, higher costs of capital and material inputs pressed on businesses. Commercial banks raised interest rates on deposits partly because of liquidity troubles.

Foreign exchange

Positive growth rate resulted in higher demand for money, and with exogenous supply, excessive demand pressure is only released when prices lower and foreign exchange rates increase (Mac Donald, 2000). Contribution of exchange rate to growth can be determined by Mundell-Fleming model as below:

$$Y^{d}_{t} = \alpha\,(s_t - p_t) - \beta\, r_t$$

In which: Y_t^d is aggregate demand, s_t is nominal exchange rate, p_t is price level, and r_t is real interest rate expectation. Expanding monetary policy in this model could bring long-term production expansion.

Real foreign exchange rate is considered one of the best tools to facilitate the economic growth while maintaining the economy's competitiveness (Eichngreen, 2008). The first and foremost lesson for fast-growing East Asian economies is to keep foreign exchange rate competitive. Turbulence of foreign exchange rate negatively affects export and investment. A stable foreign exchange rate encourages effective reallocation of production resources at higher productivity.

The SBV pegs Vietnamese Dong to US dollar at an annual devaluation of 1- 2% (mainly to handle the difference in inflation between the two economies). In 2006 and 2007, the rate VND/USD tended to increase moderately. Within 24 months, commercial banks' average rate increased from 15,900 to 16,200 VND/USD, which was a favorable condition for macro economic environment. In the first 4 months of 2008, the rate decreased more than 150 VND/USD to 15,959 in April. The unexpected reserve of foreign exchange rate in the next two months evoked chaos in foreign exchange market. The rate got back to 16,000 VND/USD in May and increased 300 VND/USD, equivalent to 2%, in later month.

In free market,[ii] signs of increasing foreign exchange rates appeared in March 2008 when difference between official rate (introduced and governed by the SBV) and free rate ranged from 150 to 250 VND/USD. On March 18, commercial banks proposed negotiable foreign exchange rate mechanism to the Foreign Exchange Department of SBV in order to deal with such widening gap.

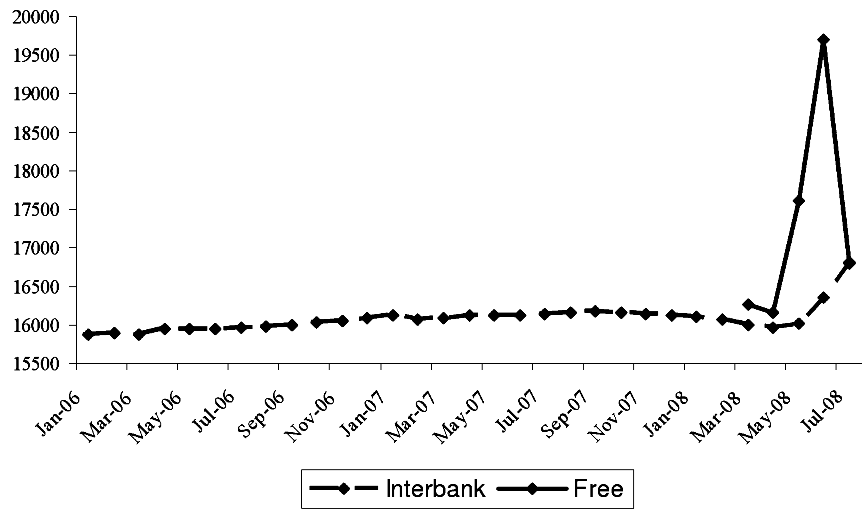

Figure 6. Inter-bank vs. Free market exchange rates * Source: DHVP. Unit: VND/USD

In June, dollar reached high record of VND19,700 before retreating to VND18,000 at the end of the month. Dramatic change in such a short time created scarcity of US dollar and difficulty in exchanging from VND to USD. In free market, exchange rates vary in every transaction. The difference between buying and selling price is quite large, from VND 200 to 300 for one dollar. Notably, Asset's survey[iii] on June 19, 2008 showed the difference in a free market transaction jumped to VND 1,000.

In a stabilizing effort, SBV raised inter-bank exchange rate by 2%, from 16,139 VND/USD to 16,461 VND/USD on June 11, 2008. Prior to that day, on June 6, 2008 aggressive administration measure had been applied aiming at halting free exchanging activities between VND and USD. Under increasing exchange rate pressure, on June 27, 2008, the Governor of SBV widened fluctuation limit to ±2%. Foreign exchange market calmed down in July 2008 when rates were converging. On July 17, free rate even was less than official rate.

Period 1997-1998 witnessed three corrections of exchange rate in July 1997 (average 11,690 VND/USD), February 1998 (average 12,664 VND/USD), and August 1998 (average 13,175 VND/USD), and the result was a 17-percent decrease in VND/USD rate (World Bank, 1998). Although, Vietnamese Dong was also devaluated, the target of these corrections was different from 2007-08 devaluations. In 1997, higher exchange rate aimed at enhancing competitiveness of Vietnamese exports. 2008 efforts were to strengthen the public and corporate confidence in the sustainability of banking and credit system, satisfying demand for foreign currencies of the economy.

Stock market

Launched in July 2000, the Vietnamese stock market made its biggest difference between sub-period 2007-08 and the rest. In macroeconomic settings, stock market reflects business investment decisions. On the contrary, macro policies and models don't take investment decisions in stock market seriously; rather they notice its ability to reflect business cycle (Fischer and Merton, 1984).

Nevertheless, the development of stock markets is considered the engine for the whole financial system and economy (Caporale *et.al.*, 2004). In stock markets, when an investor has trouble with liquidity, he sells his shares to other investors who are in strong financial condition. As a result, investment capital does not leave the businesses for individual financial needs.

It is important to prioritize developing stock markets over banking liberalization in the first stage of transition to market economy (McKinnon, 1989). Arestis, Demetriades, and Luintel (2001) conducted a survey in 5 developing economies on the relationship between stock market development and economic expansion. They concluded that efficiency of stock markets contributes to economic growth, but less than banking system does. In monetary aspect, development of stock markets provides effective instruments to implement monetary policies by issuing and buying back government's securities in liquid markets.

In the first 5 years, Vietnamese stock market grew modestly. After the establishment of Hanoi Securities Trading Centre, number of listed companies has been increasing very fast since 2005. 12 months of 2006 alone added 146 new stocks, tripling accumulative number of the previous 5 years. Financial intermediaries have mushroomed since then. As of July 2007 there were 92 securities firms, 30 funds management firms, and 298,000 individual securities trading accounts, of which 7,000 were of foreigners.

The upward trend of Vn-Index was preserved from second half of 2006 to first half of 2007. Vn-Index was recorded with 4 digits on January 17. Then it peaked 1,171 on March 12.

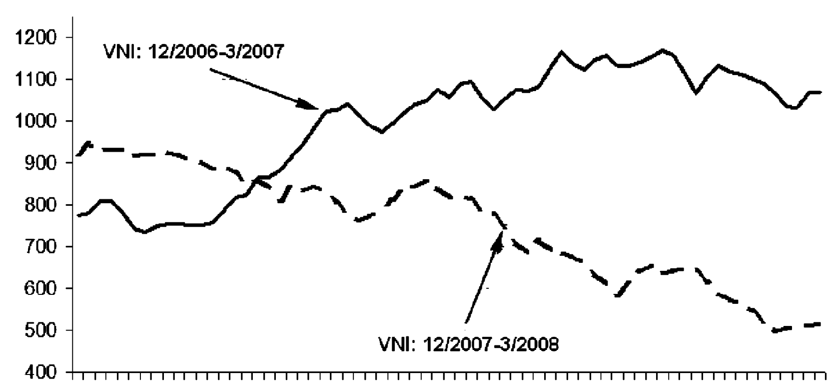

Figure 7. Fluctuation of VN-Index, 2007-08 * Source: DHVP

Achievements in 2006-2007 were wiped out by the downturn in 2008. The market composite was at bottom of 395 on June 4, 2008. Reverse trend of stock markets made investors, especially individuals, panic. When the markets were glorious, personal saving is not substantial enough to make significant profits from stock trading. People try to raise sufficient funds from friends, relatives, and banks. As a result, when stocks went down, financial obligations burdened an unaccountable number of people. Pessimistic and even extreme behaviors were understandable. But, the appearances of instability of the nation's financial system as well as massive conflicts of interest were being clearer with a great concern (Pham and Vuong, 2008).

The market turbulence affected not only financial asset exchanging but also real estates and credit (Vuong and Nguyen, 2008). The boom of stock markets in 2006 has brought investors huge profits. These money went to real estate market traditionally. In the first quarter 2007, the demand for real estate surged. Housing prices rocketed in the second quarter 2007. Even when stock markets loomed in later half of 2007, real estates still opted as favorite alternative of investors. Big losses appeared in early 2008 when both markets had troubles, especially liquidity.

Growth of stock markets encouraged commercial banks provide more loans to financial investors. Financial assets, later, were mortgaged in commercial banks for further bet on the game. To guarantee safety and stability of the banking system, on May 28, 2007, SBV requested that loans for stock investment not exceed 3% of total lending. Although, markets responded differently with tight credit condition, its effect on slowing over excitement in stock trading activities was recognized.

When there was no existence of stock market, foreign capital mainly flowed into Vietnam through FDIs. In period 1992-1997, FDI made up from 5 to 10 percent of annual GDP. Another way is foreign portfolio investment (FPI). There were about US$ 700 million of FPI together with 8 investment funds operating in early 1990s. However, lack of investment opportunities, small scale of markets, low liquidity, and financial crisis in 1997, had strayed the capital flows away from Vietnam. Not until 2005 when stock markets gave out good signals, did international investors get back in Vietnam (Vuong and Tran, 2008).

Foreign capital flows

The economic liberalization has brought fruitful results in foreign trade activities with increasing import and export turnovers. Nevertheless, trade deficits have been increasing since 1999. Foreign currency reserve has been built up mainly on FDIs and FPIs in recent years.

Table 3. Balance of Payment 2004-2007

	2004	2005	2006	2007	2007 (*)

Current Account	**- 1.6**	**0.2**	**0.2**	**- 6.4**	**- 9.0**
Goods & Services Balance	- 3.2	- 2.0	- 2.8	- 9.0	- 12.6
Investment Income Balance	- 0.9	- 1.2	- 1.4	- 1.6	- 2.3
Net transfers	2.5	3.4	4.4	4.2	5.9
Capital Account	**2.6**	**1.9**	**4.1**	**15.2**	**21.4**
Net FDI	1.9	2.0	2.4	4.0	5.6
Other financial flows (net)	0.7	- 0.1	1.7	11.2	15.8
Change in Reserves	**+ 1.0**	**+ 2.1**	**+ 4.3**	**+ 8.8**	**+12.4**

Source: IMF; (*) percent of GDP; Unit: VND bln.

In 2007, trade deficit tripled prior year, which equivalent 13% of GDP. About 40% of capital inflows (accounted for more than 21% of GDP) were used to offset the deficit of current account. In previous years of 2005 and 2006, most of capital account balance was transferred to foreign reserve. When capital account surplus doubled from US$ 1.9 to 4.1 bln., foreign currency reserve changed correlatively from US$ 2.1 to 4.3 bln.. The SBV bought US$ 8.8 bln. surplus to enrich national reserve.

It is noted that in the 1980s, grants of Soviet Union played important role in Vietnamese economy. However, this source reduced sharply in 1990s and was replaced by ODA form Northern European countries. International political reasons prevented development organization from directly financing Vietnam's economy until 1993. International donors focused on technical assistances and capacity building not financial aids during 1989-1992. In this period, annual ODA was less than 1% of GDP.

Increasing FDI capital flows and strong portfolio investment are major differences between period 2007-08 and 1997-98. The financial crisis in 1997 attacked banking-credit systems and created massive capital-flight in East Asian nations. Big FDI investors to Vietnam came from neighboring countries. And they also suffered immediate shortage of cash. Thus, investment processes were stagnant.

3. A comparative analysis 1991-92, 1997-98 and 2007-08 sub-periods

Economic turbulences in 1991-92, 1997-98, and 2007-08 witnessed similar signals of lower growth, smaller investment and consumption, higher inflation, and lack of employment. However, there are fundamental macro economics distinctions over sub-periods in term of source of downturn, complication level, and effects of macro policies.

Major distinctions over sub-periods

Each period of development has its own distinctions. Macro remedies therefore vary. In 1997, financial disorder led to unexpected movement in confidence of economic growth in East Asian countries (Radelet and Sachs, 1998; Marshall 1998; Chang and Velasco, 1999). Misaligned macro policies and economic structures (Corsetti, Pesenti and Roubini, 1998; Dooley, 1999) were considered two direct causes. To deal with financial difficulties, Vietnamese government expanded money supply. Interest rate cut promoted investment and consumption. Vietnamese Dong devaluated 17% within 12 months to improve competitiveness of Vietnamese exports.

It was contrary in 2008. Emerging price index forced SBV to follow a tight monetary policy with all its weapons. Primary, discount, and re-finance rates were set higher. SBV also tried to be active on open market operations. But these attempts were in vain. International financial turmoil, rocketing oil price, and dynamic variation of gold exacerbated the situation in Vietnam.

Table 4. Distinctions over sub-periods of 1991-92, 1997-98, and 2007-08

Criteria	**Content**		
	1991-92	**1997-98**	**2007-08**
Growth	7% (average)	1993-1997: 9% (average) 1998-2000: 7-8%	2002-2007: 7.9% (average) 6/2008: 6.5%
Inflation	High: 67,5% (1991) Sliding trend	1996-2000: deflation Positive interest rate: 4.6%p.a. (1996-2000)	Increasing. 2007: 12.6%. First five months of 2008: 19%
Interest rate	Maintaining positive interest rate to control inflation	Reducing discount rate: 0.05%/month lower than re-finance rate Reducing re-finance rate by 0.4% (Sep. 4, 1999) Difference between borrowing and lending rates: 4.2%p.a.	Increase re-finance rate by 1% (Jan. 30, 2008) Increase discount rate: 1.5% (Jan. 30, 2008) Increase primary rate: 14%p.a. (Jun. 10, 2008) Interest rate limit: ± 150% primary rate
Exchange rate	Start settling in hard currencies (USD…)	Vietnamese dong devaluated 17% within 12 month by three adjustments	Exchange rate reduced in 2006-07 then Vietnamese dong sharply devaluated in first half of 2008.

			Gap between bank and free market exchange rates reached 20 percent.
Foreign investment	Small FDI Small ODA Soviet Union grants stopped	FDI played important role Sharply reduction of foreign inflows due to Asian financial crisis.	Foreign inflows boomed. FPI exceeded FDI in 2007 (three times higher)
Stock market	Not available	Not available	Important market in the financial system. Inter-connection with monetary and real estate markets (Vuong, 2008) Large socio-economic effects
Integration	Soviet bloc	Region: ASEAN (1995), AFTA (1996), APEC (1998)	Global: US-BTA (2001), WTO (2007)

1997 Asian financial crisis caused an abruptness in foreign investment capital flows. A series of projects had to settle tardily or delay infinitely. However, the majority of Vietnamese partners contribute to projects with land, buildings or labors. Therefore, delays in projects just meant that those assets had not come into value creation process rather than putting businesses under financial burdens.

Stock market turmoil in the first half of 2008 closed an important fund raising channel. Many Vietnamese firms faced insolvency as most of their "money" stayed with under-construction projects. Moreover, investment decisions had been made during planning and financing process, thus such projects were very low feasible and commercial. Commercial banks became the only funding source for short-term liabilities. But they themselves were facing liquidity troubles. Second quarter of 2008 experienced a fiercer interest rate competition among commercial banks.

In 1997-98, company sizes were modest. A survey on 12 leading small and medium-sized companies in different industries showed that capital needs and asset just stopped at some millions US dollars (Vuong, 1997). The average need for capital was \$1.3 million; asset was \$2.1 million. After 10 years, the existence of companies with VND hundreds-of-bln.s-asset worth and bln.s-dollars projects was not astonishing. What made this difference? With greater sizes, have competitiveness and value creation capabilities increased correspondingly? (Vuong: 2007, pp. 42-43).

4. A note on further research needs

The complexity of economic downturn in 2007-2008 increased as Vietnam upgraded from regional to a global game. The US. sub-prime mortgage crisis sent a far-reaching signal to Vietnam, but commitments to trade, and investment liberalization caused direct effects. The present situation has been far more complicated due to not only the increasing number of economic players but also greatly different structures and sophistication of transactions. New concepts were introduced such as public company, portfolio investment, merger & acquisition etc. The global integration game also gave rise to the public's awareness of branding, intellectual property right, business communications, and corporate governance. Most of these had not been in place before the turn of the century.

Cautious observation

The world economic machine is running at high speed. Vietnamese economic agents and indices move incessantly. Cautious observation and focus on core factors of the economic system should be of great importance.

In the period 1995-96, China- the fastest growing economy in the world with institutional similarity to Vietnam- faced macro problems namely the devaluation of Yuan, accelerating inflation… which had been settled by aggressively remove non-profitable small banks. To this end, China built up its financial strength and competitiveness, a bold move before its entry into WTO in 2005. It should be noted that the economy has grown up incredibly since the abandonment of the centrally-planned model and moving closer to macro management of well-developed economy.

Vietnam is now facing familiar increasing interest rates, price-inflated inputs, and limited capabilities of managing resources efficiently. Consequently, a number of non-profitable businesses will disappear. A well-designed bankruptcy law helps accelerate the filtering process and facilitate start-up of new businesses. Negative perception of business people should be changed while policy makers and economists continued their search for a sustainable economic model. Freedom to business doing and value added creativity should play a pivotal role in the process.

Super power of banking system

The history of Vietnam acknowledges super power of banking system. Even when stock markets were the most bullish, this position never changed. Bank credit is an important force driving stock market. Tight credit policies on securities lending were strongly opposed by stock market players. A healthy banking system ensures stable corporate financial performances.

Performance and operation of the banking system should be managed highly carefully. Upgrading risk control, building credit rating system, applying modern technology… and seeking for optimal banking operations are encouraged. However, in present days, the first and foremost task of banks is to exist and get over the credit crunch. Authorities are responsible for difficult jobs of supporting commercial banks operate properly and prevent the system from a spill-over effect. Moreover, Vietnamese people and government should well understand that although the banking system follows market rules of supply-demand-price, it should run for the benefits of society not small group of people (Song, 2007).

Roles of information and communication

Technology and communication infrastructure of 2007-08 outruns period 1997-98 not to mention period 1988-92. It provides people with wonderful and plentiful information at reasonable costs. The quality of information becomes critically important when quantity booms. Lack of research capability and asymmetric information are negative taxes. People have to pay such taxes but money goes into vault of speculators not the government. Ensuring information access fairness, exactness, and honesty is a must to communication systems and the media.

A strong economic research and forecast capability provides reliable information and knowledge. In Vietnam, the voices of government institutions are the most important signals to markets. However, publishing research results and providing reliable information have not been major functions of Vietnamese top management institutions such as State Bank of Vietnam, State Securities Commission, and Ministry of Finance. In transition progress, authorities prefer ordering and supervising implementation of central government decisions to facilitating interactions among economic agents. Governance should shift from controlling to a research-information-communication-promotion market forces mechanism.

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[i] Vietnam is a member of ASEAN (July 25, 1995), AFTA (January 1, 1996), APEC (November 1998)
[ii] Free foreign exchange market sometimes is called black market. It consists of privately-run foreign exchange transaction tables, jewelry shops, and the likes. According to SBV’s statistics, in June 2008, there were 3,591 foreign exchange tables in Vietnam. Of which 921 were in Hanoi, and 1,219 in Ho Chi Minh city.
[iii] www.asset.vn/english is a professional website providing Vietnamese economic and business- focusing on finance, banking and investment, information and statistics. In July 2008, the website is the largest online business and business research community in Vietnam with nearly 50,000 registered members.