Currency Policy - International Experiences and Lessons for Vietnam

Vu Ngoc Xuan[1],

[1] Director Centre, Faculty of Economics, National Economics University
Address (207 Giai Phong Road, Hai Ba Trung Dist, Ha noi, Vietnam)

ABSTRACT— ***In recent times, Vietnam has been successful in maintaining a currency policy aimed at stabilizing the exchange rate, macroeconomic stability, and inflation remained at a low number. In 2012, Vietnam exported 284 million dollar trade, balance of payments surplus of 9.1 billion dollars, foreign exchange reserves doubled to reach about 30 billion dollars. Vietnam and other countries are faced with the globalization of the financial markets in 1990-2000, thereby reducing the stability of the exchange rate and policy autonomy of states. An unintended consequence of financial globalization is the loan with the costly expense of developing countries and the debt crisis. Countries with emerging markets responded by choosing monetary policy with the aim of controlling cash flow for the three policy impossible, integrate their finances with rising foreign exchange reserves, as self-insurance means the integration into the global financial system. Policy impossible trilogy (the ability to perform only two of the three policy goals - free flow of capital, exchange rate stability and an independent monetary policy) continues to be a model of management policy in macroeconomics. This article, the authors use the model impossible trinity of Robert Mundell and Marcus Fleming model (Mundell - Fleming) to explain the objectives of monetary policy Vietnam period before the WTO (1990 -2007), and after joining the WTO (2007 - present). The author updates the national experience of the world and draw lessons options for monetary policy in Vietnam in the coming time.***

Keywords— independent monetary policy (monetary independence), world trade organization(WTO), full capital controls, impossible trinity.

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1. INTRODUCTION

An important contribution of Mundell and Fleming is trio impossible (Impossible Trinity or The Trilemma). A country can choose 2 targets at the same time but can not select any of the three goals: monetary independence, exchange rate stability and the free flow of capital and financial integration. Triangle Impossible trilogy is illustrated in Figure 1. Each of the three corners of the triangle represents the first target is impossible but we never get all three corners of the triangle at a time.

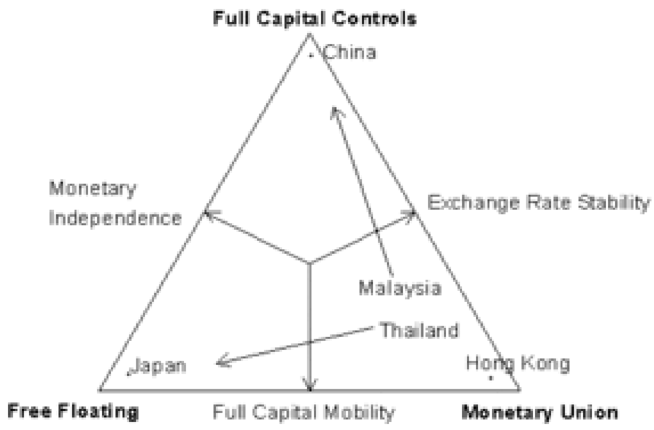
2. APPLYING THE IMPOSSIBLE TRINITY OF CURRENCY POLICY

Analysis Figure 3 shows, the top labeled "control strong cash flow "is China's choice, choices relating to the autonomy of monetary policy and exchange rate regime stability. This is China's choice from 1990 - present. Top left, labeled "mechanism floating exchange rate", in relation to the selection of an independent monetary policy and free flow of capital (financial integration) - the preferred choice of the United States, Japan for more than 3 decades.

The top right, labeled "monetary union" means to give "independent monetary policy", in relation to choosing stable exchange rates and free capital flow - the preferred choice of the euro zone countries, Hong Kong and Argentina in the '90s.

The prediction of the three sharp impossible clear visual interpretation of it is done through an open economy model of neo-Keynesian. Nowadays, the insight is also shared by academics and policy makers. Prolonged challenge is in fact, most countries in the neutral model trio are facing impossible challenges knowledge than the nations near the top pick of the triangle. Even in the rare instances via a robust version of a system of fixed exchange rates (such as the monetary regime chosen by Argentina in the early 90s), the credibility of the exchange rate change to fix time-consuming and rarely central bank under strict version of the National Monetary Council. Similarly, countries choose a mode flexible exchange rate, sometimes to intervene actively in the foreign exchange market, and end the performance of different versions of a floating system. Moreover, most of countries operate within financial integration part, where restrictions on capital flow. Understanding the mixed mode is still a challenge.

Figure 3. Tradeoff between the Impossible Trinity



Source: Compiled by the author based on Frankel, J. (1999) "The International Financial Architecture," *Policy Brief*, No. 51, The Brookings Institution.

Figure 3: The trade-offs and the impossible trinity

(Source: author Frankel J (1999), the financial architecture international policies of 51, Brookings Institute)

Testing predictions of the three models Impossible continues to be studied, there is no single way to define and measure the degree of exchange rate flexibility, monetary autonomy and fiscal integration. Integrated financial model suitable alternative limited between the assets remains controversial. Nevertheless, even in this situation, the impossible trinity is still a strong model. An important message of the impossible trinity is the scarcity of policy tool. Policy makers faced with problems such as high financial integration will cause decrease in weighted average of the other two variables (to lower the exchange rate stable, or lower monetary independence, or a combination of the two.)

We continue to consider the option of changing Trilemma countries during recent decades later, then discuss the empirical literature dealing with the development Trilemma choices, and finally explains the challenges facing the country have found direction Trilemma choices during globalization.

3. CURRENCY WAR BETWEEN THE COUNTRIES

U.S. While forced Chinese currency manipulation by controlling the free flow of capital, but always keep the Yuan exchange rate stable at a low level through the implementation of an independent monetary policy to support exports, President Putin Russian accused the United States and rogue states are involved in supporting the opposition against a Russian uniform. Brazil accused the United States continuously perform quantitative expansion (from QE1 to QE4), Federal Reserve Department (FED) pumping money caused inflation globally. Government of Japanese Prime Minister recently issued monetary policy as "Abenomics" that is pumping money to keep the yen weak to stimulate exports'. All spark a currency war worldwide. Recently, this theme appears repeatedly in the study of economics scholars everywhere. Theory Impossible trilogy including free flow of capital, exchange rate stability and an independent monetary policy as the above analysis helped explain this problem. If in his new term, President Barack Obama and the U.S Congress resolute perspective accusations that China is a country of currency manipulation. So will the currency war between the two largest economies in the world and how this can be resolved in the current situation. developed Countries including the United States and Japan were affected from the financial crisis in 2008 led to lower interest rates close to 0 profit from investment is very low. This means that emerging markets such as Vietnam, China and ASEAN countries will have better return on investment, so flows are moved to the country

Example since Vietnam joined the WTO in 2006, investment flows both directly and indirectly to increase cash Vietnam the price increase. If the government does not intervene in the currency market, the strong demand in Vietnam to Vietnamese currency appreciation. Dong Vietnam will raise to disadvantage due to commodity exports will be more expensive in Vietnam on international market. Therefore, the State Bank of Vietnam had to buy nearly $ 10 billion to prevent the appreciation Vietnam. Problem is to intervene in the currency market in such a way as to increase the money supply. According to the theory of the impossible trinity, Vietnamese are choosing a point near the top of the triangle like China. Intervention by pumping money to buy foreign currencies is the choice of Vietnam centrist policies. Scores for choose this time to the right toward the top of the triangle, but not at the very top as the EU, Hong Kong. This results in part during the period 2006-2011, Vietnam must accept inflation rate high inflation's peak in 2011, inflation reached 18.13% and interest rates are above 20% caused a series of corporate bankruptcies, bad debts in the banking sector increased by 8.8% (according to data from the State Bank.) 2012 also saw the bubble burst of the real estate market and the financial markets. Since 2006, Vietnam also saw the global financial crisis, debt crisis in Europe, the bubble burst of the real estate market in China. Whereas, in the U.S. to rescue the local economy, the government applies the impossible trinity and choice shift from left corner to right corner of the triangle, i.e. choose free flow of capital, exchange rate stability and to give up independent monetary policy. During the last 5 years the Fed has been pumping several trillion dollars to rescue the economy with quantitative easing, QE1 and QE4.

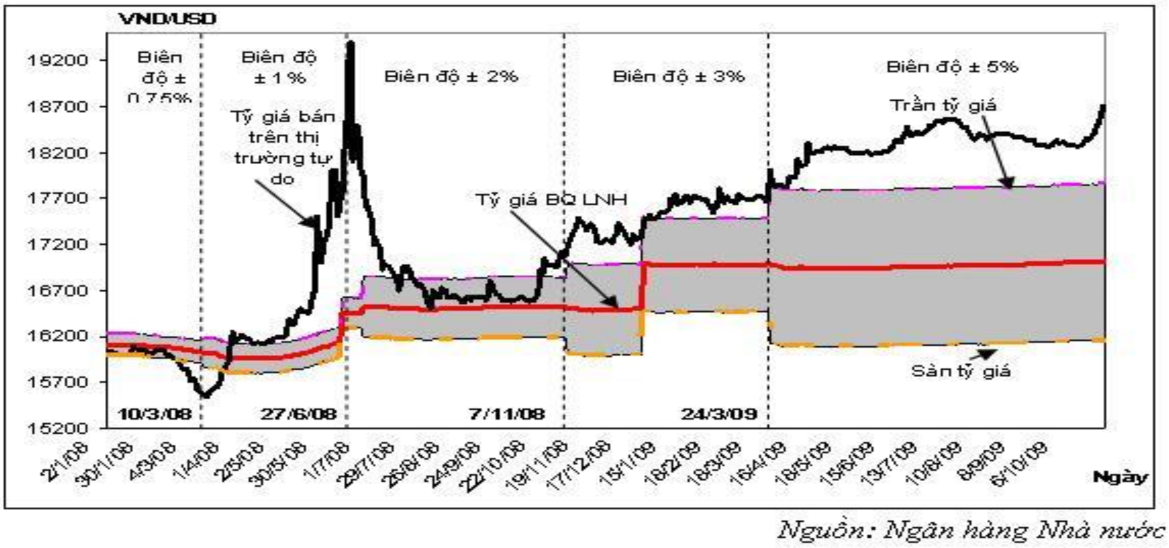


Figure 1: The exchange rate between Vietnam dong and U.S. dollar during the period from 01.2008-10.2009

(Sources: Vietnam State Bank, 2012)

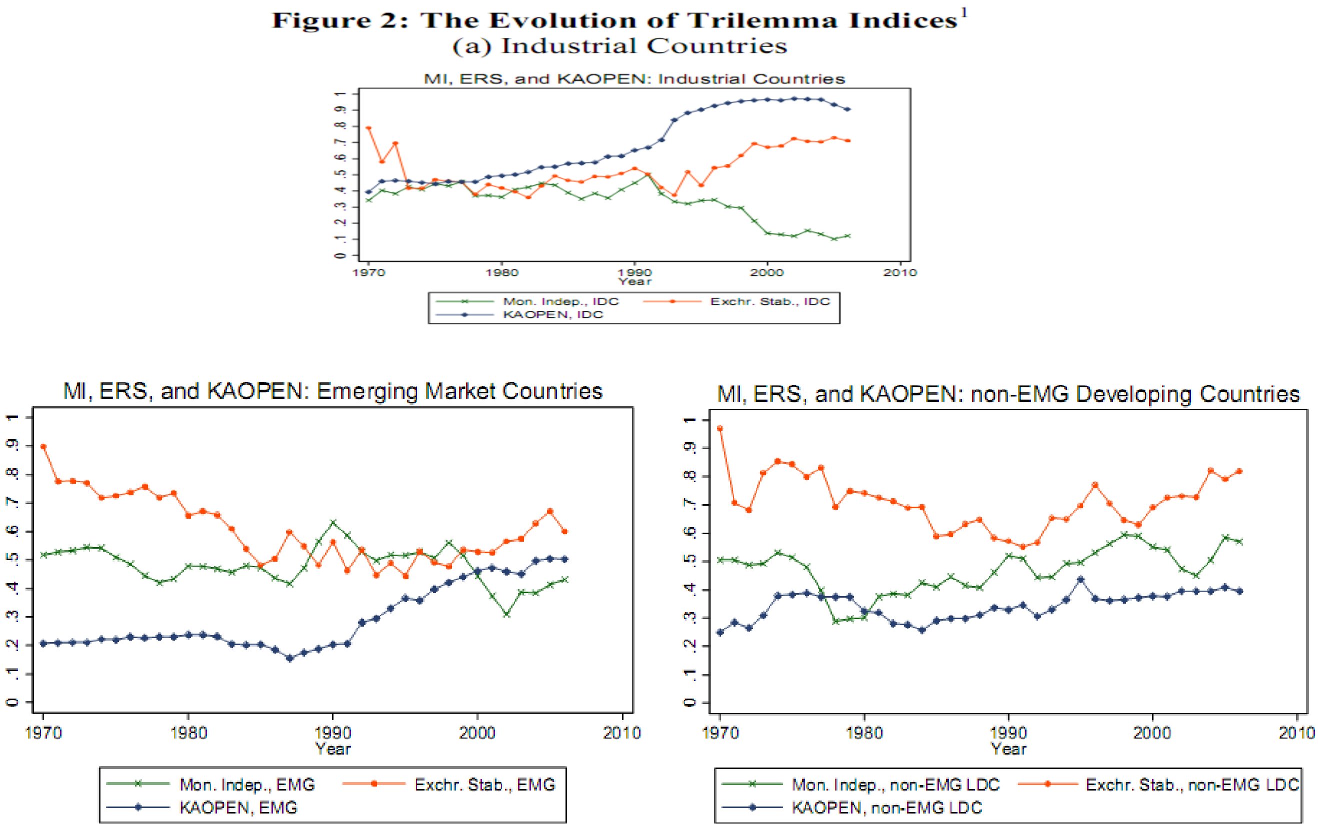


Figure 2: The Impossible trilogy. Picture the (industrialized countries), the left corner (emerging market countries), the right angle (the developing countries are not emerging markets). Green line (independent monetary policy), blue (free cash flow), Orange (exchange rate stability)

(Source: Joshua Aizenman, Department of Economics, University of California, Santa Cruz, USA)

4. TRENDS IN SELECTION OF THE IMPOSSIBLE TRINITY OF THE COUNTRIES

Figure 2 summarizes the changes of the impossible trinity 1970-2006 periods. This image shows the index of the impossible trinity in 50 countries (32 developing countries) during the period 1970-2006, with the same data set. Figure 2a shows that industrialized countries reduce significantly the level of exchange rate stability in the years 1970-1980. In general, for the industrial countries, financial openness accelerated beginning in the 1990s. The stable exchange rate increased after the late 1990s, reflecting the period of emergence of the euro in 1999. Along with the model predictions of the impossible trinity, independent monetary policy tends to decrease since the early 1990s.

Looking at the group of developing countries, we can see that there are differences between emerging markets and not emerging. Comparative figures 2b and 2c show the emerging markets (EMS) application of the relative exchange rate flexibility, greater financial integration and monetary policy independence less than water non-growing emerging markets.

Nevertheless, in 2008 the global financial crisis led to a number of countries applying the exchange rate more flexible. At the end of this period, the EMS countries not favored the exchange rate stability and monetary independence, but the degree of financial integration is lower than the countries of the EMS.

Initial construction model of the impossible trinity focus on extreme configuration of the triangle, however, Figure 2 indicates that most of the time the selection of countries using the neutral model, not really leaning towards the top of the triangle. However, after a long period applies, the crisis did most industrialized countries now choose the money toward a vertex of the triangle the impossible trinity.

5. CHECKING OF THE IMPOSSIBLE TRINITY MODEL

Test correctly predicted by the model Trilemma is still a challenge. While schools of orthodox economists see as the obvious Trilemma, most developing countries like Vietnam are selected and the neutral model is not at the top of the Trilemma. Another concern may be the Trilemma framework does not impose a limit function correctly the relationship between the three policy variables with respect Trilemma configuration outside the top three Trilemma. Moreover, the measure of financial integration, exchange rate flexibility and monetary independence in powerful ways is still a challenge. Restricted to capital is often very difficult to operate and measurement. So it is only limited to the capital flow but still illegal rotation? Or assume the assets capable of perfect substitutes? What will happen if domestic financial sector in crisis? It can replace the impediments to financial flows in the country by various means such as reserve requirements on bank deposits responsibility (a policy often used in China, India)? These issues are of key importance in the evaluation of the integration on the financial reality of a country

In the time of fixed exchange rates in the classic gold standard, a significant and rapid interest rate shocks are found. This is consistent with the prediction that the fixed exchange rate with the flow, working capital invalidates independent monetary policy (corresponding to the right vertices of the triangle Trilemma). Conversely, in the era of the Bretton Woods fixed exchange rate did not resolve restriction rate in the country, a byproduct of capital controls widespread (corresponding to the top of the triangle vertices Trilemma). In the post-Bretton Woods era, reversion model of globalization is expressed through another round of interest rate increases in the number of countries with fixed interest rates.

According to test models of the impossible trinity of To Trung Thanh (2012), with data sources provided by state-owned banks and IFS (IMF) were collected quarterly from 1990 to 2007. Model regression as follows:

$1 = \alpha MI + \beta ERS + \delta KOPEN + \varepsilon i$

Where, MI: monetary policy independent

ERS: exchange rate stability

KOPEN: free circulation of capital

Value of MI higher mean primary monetary policy more independent, ERS bigger the more stable exchange rate, the greater the KAOPEN more open capital markets.

The estimated coefficients are significant at the 1% level statistics with the use of regression obtained as follows :

MI + 0.47 0.54 + 1.71 KAOPEN ERS = 1

The average values of the variables as follows: MI = 0.46; ERS = 0.76; KAOPEN = 0.18

Table 1: The regression model tested the existence of the impossible trinity

Dependent variable: 1		
Mean	MI	0.467021
	ERS	0.761329
	KAOPEN	0.183900
Estimated coefficient	MI	0.540809
		(0.00) ***
	ERS	0.467000
		(0.00) ***
	KOPEN	1.712224
		(0.00) ***

(Source: To Trung Thanh, Inspection of the impossible trinity in Vietnam and implications for choice policy options for the future, Journal of Development Economics, National Economics University, 2012)

Thus, if you take the average value the diagram in Figure 2, Vietnam in 1990-2007 had a choice in the highest exchange rate stability (ERS = 0.76), then the monetary policy independence (MI = 0.46) and sacrificing the free flow of capital (strictly control the circulation of capital-KAOPEN = 0.18).

6. EXPERIENCES OF CURRENCY POLICY TO VIETNAM IN THE NEAR FUTURE

From the analysis in above, during the period 1990-2007, Vietnam's economy has maintained high GDP growth rate of the moon with an average close to 7% for almost 20 years to the time of joining the WTO, thus the reason for Vietnam was the top choice of the top three nearly impossible to top of the triangle - the same choice with China. Vietnam has the advantage of being close to China - the 2nd largest economy in the world, with a GDP growth rate of about 7% in 2012, the nominal GDP 8,000 billion if calculated according to purchasing power parity (PPP) China's GDP reached 16.000 billion U.S. dollars. Meanwhile, the U.S. economy is the world's largest nominal GDP in 2012 was about 15,200 billion, if calculated according to purchasing power parity is only about 15,200 billion dollars, because goods and services are priced in the U.S. much higher than the average Chinese. Thus, the fact proved today China has become the world's number one economic power. China has emerged as a dragon of both world economic power, and military influence in organizations such as the IMF, World Bank and United Nations.

During the period 2008-2011, Vietnam joined WTO, a major shift in investment flows directly or indirectly from abroad. The policy makers have shifted the model choice impossible trilogy from the point near the top of the triangle to the middle model, allowing the free flow of capital, stable exchange rate policy, with independent monetary policy (ie moving toward the right corner of the triangle Trilemma). This is not possible, leading to the lack of consistency in policy making. Along with the global financial crisis that started in 2008 from the U.S., the debt crisis in Europe in 2011, the bubble burst of the real estate market and the year 2011 in Vietnam. Our country badly affected with GDP growth slowing to an average of about 6% in the 2008-2011 period, inflation rate peaked at 18.13% in 2011, public debt and foreign debt was arrivals increased by 54.6% and 41.5% end of 2011, deficit ratio in Vietnam at nearly 5% of GDP.

In 2012, Vietnam has highlighted the macro economic inflation rate was controlled at a number (6.81%), the growth rate of 5.03% of GDP (2012 GDP of about 136 billion U.S. dollars). Income per capita was $ 1,540. If calculated according to purchasing power parity (PPP), the income of the people of Vietnam have averaged approximately $ 4,500 / person (due to goods and services in Vietnam have lower average prices in developing countries world). Balance of payments surplus of $ 10 billion, from $ 9.8 billion deficit in 2011, moved to Vietnam, U.S. $ 284 million surplus in 2012. Thus, for the first time after 20 years, Vietnam has become a net exporter, it is significant in light of the stable exchange rate helped reduce the national debt burden due to the devaluation of the dong. 2013, the economy is expected to continue in Vietnam surplus, GDP growth reached 5%, inflation will be maintained at a figure of about 6%, the interest rate is now down (interest rates about 5-8% / year, about 10-15% of loans / year) to facilitate ease financing costs for businesses.

Returned to Vietnam selects the top model in the triangle of the impossible trinity, that is, model selection like China: exchange rate stability, monetary independence and sacrifice issue of "free cash flow". Government should have policies to control the flow of capital into and out of the economy. The control of the gold market, the foreign exchange market in 2013 has achieved significant achievements. Risks from the last time the gold has fallen sharply since foreign banks stopped lending and mobilizing capital in gold. Thus, the consistent implementation of the three models Impossible Vietnam will step out of bad debts in the banking sector increased nearly 9%, the overall restructuring of the economy and characteristics especially the operation status of the inefficient state-owned enterprises. The introduction and operation of the asset management company VAMC on 7/2013 should contribute to gradually resolve bad debt, boost growth in the near future.

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