Annexes: Selected Issues

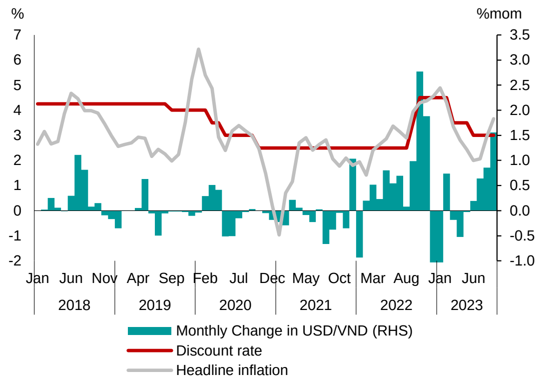
1. Vietnam's Monetary Policy Framework and Operation[48]

1. **The State Bank of Vietnam (SBV) continues to employ direct monetary policy instruments to achieve its policy objectives.** The central bank consistently applies direct controls over credit growth and multiple operating interest rates simultaneously. In 2023, amid slower economic growth with subdued inflation, the SBV raised its indicative credit growth, assigning credit growth quota to individual banks, and reduced operating interest rates. Recently, in the course of strong U.S. dollar appreciation, the SBV has also withdrawn liquidity through open market operations (OMOs) to stabilize the Vietnamese dong. Vietnam's monetary policy is different from many other ASEAN+3 economies, which have adopted an inflation targeting framework with a single short-term interest rate as their central bank's operational target. Thus, this selected issue delves deep into the SBV's monetary operations and policy instruments.

Monetary Policy Framework

2. **The State Bank Law identifies ensuring price stability as the primary monetary policy mandate[49], but in practice, monetary policy is also used to serve other policy objectives.** According to the Law on the State Bank of Vietnam 2016 (Article 3), monetary policy aims to maintain stability of the currency value (inflation rate), and the SBV is mandated to use tools and measures to achieve this objective. However, it has been observed that monetary policy could be employed to achieve macroeconomic growth target and exchange rate stability.. For instance, following the U.S. Federal Reserve's unexpectedly aggressive rate hike in July 2022, the dong depreciated significantly against the U.S. dollar. Despite headline inflation remaining within the 4 percent annual ceiling with mild demand-side pressures, the SBV tightened monetary policy drastically by increasing operating interest rates and absorbing liquidity from the financial system through OMOs to contain the currency depreciation (Figure A1.1).

Figure A1.1. Monetary Policy Direction, Inflation and Exchange Rate Movement



Source: SBV; Vietcombank; CEIC; AMRO staff calculations

3. **The current monetary policy framework is not aligned with the key principles of an inflation targeting regime.** In an inflation targeting regime, a targeted inflation rate or range is determined as the monetary policy goal to be achieved over the mid-term horizon. This target should not change frequently, as it serves to anchor public inflation expectations over the medium term. In contrast, the Vietnamese government and the SBV, with the approval of the National Assembly, announce the annual inflation rate target for the following year at the end of each year. Vietnam's inflation target essentially functions as a de facto

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[49] In addition to ensuring price stability, the SBV is also mandated to stabilize the currency value; ensure the safety of banking operations and the credit institutions system; ensure the safety and efficiency of the national payment system; contributing to promoting socio-economic development according to socialist orientation.

operational ceiling that the government and the SBV aim to maintain. This threshold undergoes annual adjustments based on the government's macroeconomic forecast.

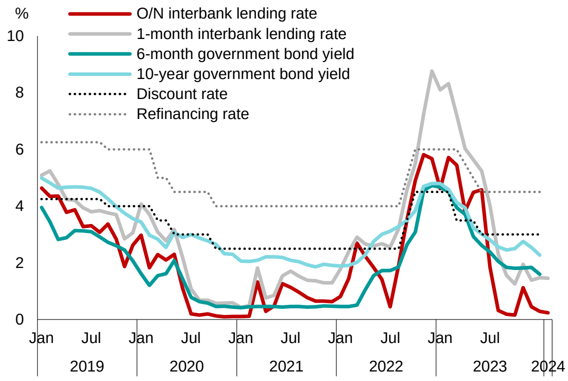
Operational Targets

4. **The SBV continues to deploy direct monetary instruments to control credit quantity and prices.** It has several operational targets, comprising a set of operating interest rates, the credit growth target, and the exchange rate trading band.

(i) Interest rate instruments

5. **There is no single benchmark interest rate, but rather controls over multiple interest rates.** Vietnam does not have a single benchmark interest rate, known as the policy rate or base interest rate, applied by the central bank in transactions with financial institutions, such as repurchase (RP) agreements. When the SBV initiated interest rate liberalization in 2000, it initially introduced a primary interest rate (PIR)[50] to guide VND lending rates offered by commercial banks (Nguyen, 2003). To this day, the PIR remains one of policy instruments, but it is no longer used to signal policy direction. Instead, in response to economic and inflation developments, the SBV controls the movement of operating interest rates that commercial banks use to transact with their clients, including short-term deposit rate caps and lending rate caps for priority sectors (Table A1.1), while allowing other deposit and lending rates to fluctuate through market mechanisms. Furthermore, the SBV adjusts the discount rate and refinancing rate, which serve as reference rates in its lending facilities. These two rates are solely used to signal monetary policy direction but are not employed in OMOs. Consequently, Private commercial banks use deposit rates of state-owned commercial banks as the base rate in calculating their lending and deposit rates. There is also a limited connection between such operating rates and money market rates or bond yields. (Figure A1.2)

Figure A1.2. SBV Operating Interest Rates and Market Interest Rates



Source: SBV; Hanoi Stock Exchange; Haver Analytics; AMRO staff calculations

6. **Based on anecdotal evidence and discussions with commercial banks, the interest rate policy could be transmitted to bank lending and deposit rates through the operations of state-owned commercial banks (SOCBs).** Although the government has gradually allowed SOCBs to operate independently, these banks still dominate the banking sector and support the implementation of the government's policies. SOCBs always adjust their deposit rates immediately following the SBV's announcement of operating rate changes,

[50] The Law on the State Bank of Vietnam gives the SBV the mandate to announce the PIR and other interest rates for the purpose of conducting national monetary policy and combatting usury. The SBV issued Circular 16/2008/TT-NHNN on May 16, 2008, which specified that it would publicly declare the PIR every month. Credit institutions were granted the autonomy to determine their lending rates, provided that they did not exceed 150 percent of the PIR. However, on April 14, 2010, the SBV issued Circular 12/2010/TT-NHNN, which repealed Circular 16 and allowed credit institutions to freely negotiate lending interest rates with borrowers without adhering to the 150 percent margin. The last official announcement of the PIR was on November 29, 2010, which declared a base interest rate of 9 percent per annum effective from December 1, 2010. Although the SBV ceased to declare the PIR at the end of 2010, the 9 percent rate has continued to be widely referenced in laws and contracts, serving as the benchmark rate for resolving civil disputes in court. It can still be considered valid to this day, as stipulated by the State Bank law.

even when the central bank does not conduct OMOs to adjust liquidity in the financial system and influence short-term market rates. Since a single benchmark interest rate is absent, and the SBV's monetary operations do not aim to align money market rates with any of its operating rates, private commercial banks consistently benchmark their deposit rates against SOCBs' average 12-month deposit rates. Despite this benchmarking, private commercial banks offer varying deposit rates as the levels are also subject to liquidity at the individual bank. For private banks, their lending rates reflect their financial and operational costs, market competition and customers' risk premium.

Table A1.1. Adjustment of Operating Interest Rates in 2023 to Tackle Growth Slowdown

Instrument	Prior to March 15	From March 15	From April 3	From May 25	From June 19
<1 month deposit rate cap	1.00%	1.00%	0.50% (-50 bps)	0.50%	0.50%
1-6 month deposit rate cap at commercial banks	6.00%	6.00%	5.50% (-50 bps)	5.00%	4.75% (-25 bps)
1-6 month deposit rate cap at microfinance institutions	6.50%	6.50%	6.00% (-50 bps)	5.50% (-50 bps)	5.25% (-25 bps)
Lending rate cap for loans made to priority sectors[1/] by commercial banks	5.50%	5.00% (-50bps)	4.50% (-50 bps)	4.50%	4.00% (-50bps)
Lending rate cap for loans made to priority sectors by microfinance institutions	6.50%	6.00% (-50bps)	5.50%	5.50%	5.00% (-50 bps)
Refinancing rate	6.00%	6.00%	5.50% (-50 bps)	5.00% (-50bps)	4.50% (-50 bps)
Discount rate	4.50%	3.50% (-100bps)	3.50%	3.50%	3.00% (-50 bps)
Overnight lending rate in SBV clearing system	7.00%	6.00% (-100bps)	6.00%	5.50% (-50 bps)	5.00% (-50 bps)

Source: SBV; Maybank; AMRO staff compilation
Note: 1/ Priority sectors include agricultural and rural development, exports, industry support, the high-tech industry, and SMEs.

(ii) Direct control over credit supply

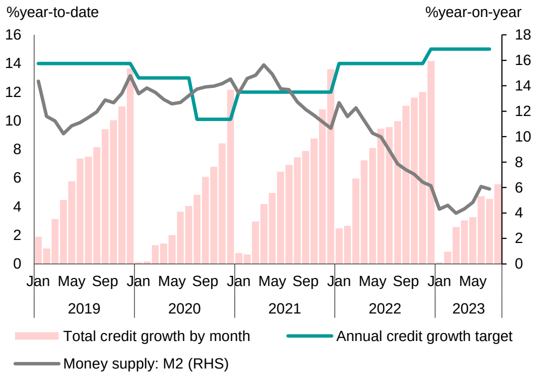
7. **Control over the credit growth is one of the SBV's primary monetary tools.** The SBV decides the *'indicative credit growth'* for the entire banking system and allocates credit growth targets to individual banks at the beginning of the year, with revisions as needed throughout the year (Figure A1.3). Credit institutions, including banks, are not permitted to extend credit beyond their individually assigned quotas, which are based on their respective financial soundness, demand, and credit expansion capacity. In addition to regulating the total credit amount, the SBV also encourages credit institutions to prioritize productive sectors such as trade and manufacturing. Prudential regulations, including higher risk weights, are applied to specific sectors to ensure that credit is not directed toward risky areas.

(iii) Exchange rate target

8. **Vietnam's exchange rate regime has shifted gradually toward a more market-determined and flexible system (IMF, 1996; AMRO, 2018).** The SBV announces the central reference USD/VND rate and its trading band daily. It calculates the reference rate based on the weighted average of the interbank exchange rate as well as the movement of the Vietnamese dong relative to eight foreign currencies of countries that have important trade, investment and borrowing-lending links with Vietnam. According to the SBV, the reference rate of VND/USD is determined based on the developments of major trading partners' currencies against the US dollar, the movement of the Vietnamese dong in the interbank market, Vietnam's macroeconomic and financial conditions, as well as the SBV's monetary

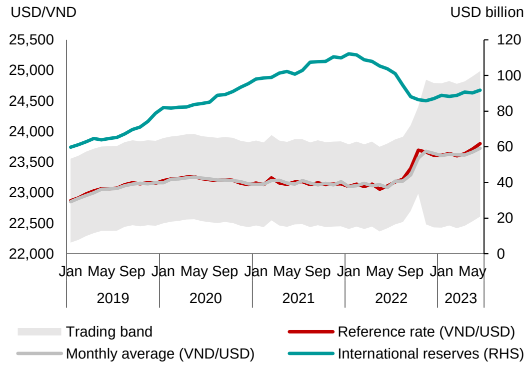
policy goal at that period. In July 2022, when the U.S. Federal Reserve aggressively tightened monetary policy, the Vietnamese dong came under sharp depreciation pressure which necessitated the SBV's intervention in the FX market in tandem with moves to mop up liquidity from the financial system to stabilize the foreign exchange market. Following this incident, the central bank decided to expand the spot exchange rate band from ±3 percent of the central exchange rate to ±5 percent in October 2022 to allow more exchange rate volatility (Figure A1.4).

Figure A1.3. Credit Growth Target and Actual Outturns



Source: SBV; CEIC; AMRO staff calculations

Figure A1.4. FX Trading Band

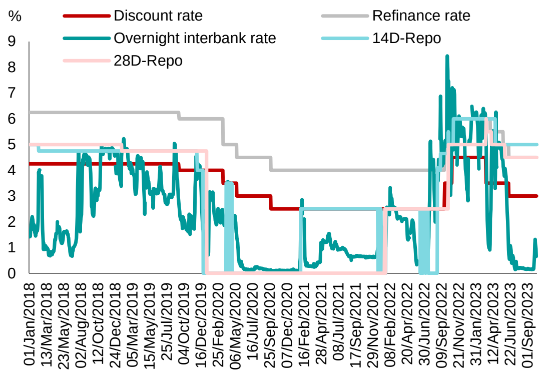


Source: SBV; Vietcombank; CEIC; AMRO staff calculations

Liquidity Management Tools

9. **The SBV continues to employ direct monetary policy instruments primarily, while the linkage between its OMOs and money market rates remain weak (Figure A1.5).** The OMOs are conducted through securities transactions and the issuance and repurchase of State Bank bills (Table A1.2). *Securities transactions* are designed to manage short-term liquidity in the banking system through outright transactions and RP transactions. RP transactions are a primary OMO instrument with three tenors: seven days, 14 days and 28 days. The SBV conducts RP transactions to ensure that liquidity in the financial system is consistent with monetary policy directions, using the overnight interbank lending rate as an indicator of liquidity conditions. The SBV intends to implement OMO to manage the liquidity condition. However, amid an absence of the policy base rate and an interest rate corridor, the SBV does not consider it necessary to align OMO interest rate with the overnight interbank rate when liquidity conditions in the banking system is stable. This partly explains the divergence of the overnight interbank lending rate and the OMO rates, especially in recent months (Figure A1.4). In addition, there is no interest rate

Figure A1.5. Monetary Policy Direction and Liquidity Conditions



Source: SBV; CEIC; Bloomberg

corridor to guide the movement of short-term interest rates alongside the OMO rate, which is preliminarily set by the SBV. *State Bank bills* are used for longer-term liquidity management.[51]

10. **Commercial banks can seek lending support from both the SBV and SOCBs.** In their day-to-day operations, these banks may face liquidity shortages due to unexpected withdrawals and will typically borrow either from the interbank market or through OMOs. When interbank interest rates are lower than OMO rates, commercial banks tend to prefer obtaining financing from the interbank market, where the primary lenders are SOCBs. Although the SBV offers discount and refinancing loans, these facilities are not widely used due to administrative procedures. Accessing such loans requires the requesting bank to provide more extensive information to the SBV compared with practices followed in end-of-day standing lending facilities offered by other central banks. Additionally, the AMRO mission has found in discussions with market participants that if a commercial bank encounters financial difficulties, the SOCBs would be instructed to provide special financial assistance to the troubled institution.

Table A1.2. Summary of SBV Liquidity Management Tools

Tools	Definition
Short-term liquidity management (OMO instruments)	
RP transaction	Repo and reverse repo are OMO instruments for short-term liquidity withdrawal and injection. There are three major tenors: seven days, 14 days and 28 days. The seven-day maturity is mainly used for daily liquidity management, while the longer tenors are pprimarily for liquidity support or withdrawal in extraordinary circumstances.
Outright transaction	The State Bank buys or sells eligible securities outright on the market to control short-term liquidity more permanently than RP transactions.
Central bank bills	The SBV issues bills to manage liquidity in the system, sterilize the purchase of foreign currency for reserve accumulation, or stabilize the exchange rate when it is under pressure. Maturities range from 14 to 91 days.
Longer-term liquidity management	
Reserve requirement ratio (RRR)	Banks and non-bank credit institutions are required to maintain a proportion of deposits with the SBV relative to the total value of deposits collected by them. The RRR varies based on factors such as the deposit currency (the dong or a foreign currency), deposit maturity and type of credit institution. The SBV does not frequently adjust the RRR in response to economic developments. The SBV pays a required reserve interest rate to compensate commercial banks for the required reserve and the excess reserve deposited with the SBV. The interest rates are 0 percent for required foreign currency reserves and excess foreign reserves, 0.5 percent for required dong reserves, and 0 percent for the excess reserve.
Discount loan	Commercial banks may request a discount loan from the SBV if they are unable to access liquidity support through the OMOs or in the interbank market to meet unforeseen demand. To obtain a discount loan, a commercial bank must provide collateral, such as treasury bills, treasury bonds, State Bank bills and other types of valuable papers stipulated by the SBV Governor during each specific period. The interest rate on a discount loan is called the discount rate (Table 1.1). It is now at 3.0 percent.
Refinancing loan	Commercial banks have the option to request a refinancing loan from the SBV when they cannot get liquidity support through the OMOs, the interbank market, or a discount loan due to insufficient assets that can be used as collateral. In such a scenario, a bank can use its loan portfolio categorized as Group 1—Standard or Pass—as collateral. The bank is allowed to secure a refinancing loan of up to 60 percent of the value of the loan portfolio offered as collateral. The interest rate on a refinancing loan is known as the refinancing rate (Table 1.1). It is higher than the discount rate, reflecting the weaker financial position of the borrowing bank. Currently, the refinancing rate is set at 4.5 percent.

[51] The SBV issues State Bank bills with various maturities—namely, 7 days, 14 days, 28 days, 3 months, and 6 months—to manage liquidity in the financial system, aiming to achieve monetary policy goals in response to corresponding economic circumstances. However, market participants and anecdotal evidence indicate that the issuance and early redemption of these bills are occasionally utilized for sterilization or to stabilize the exchange rate when it comes under pressure.

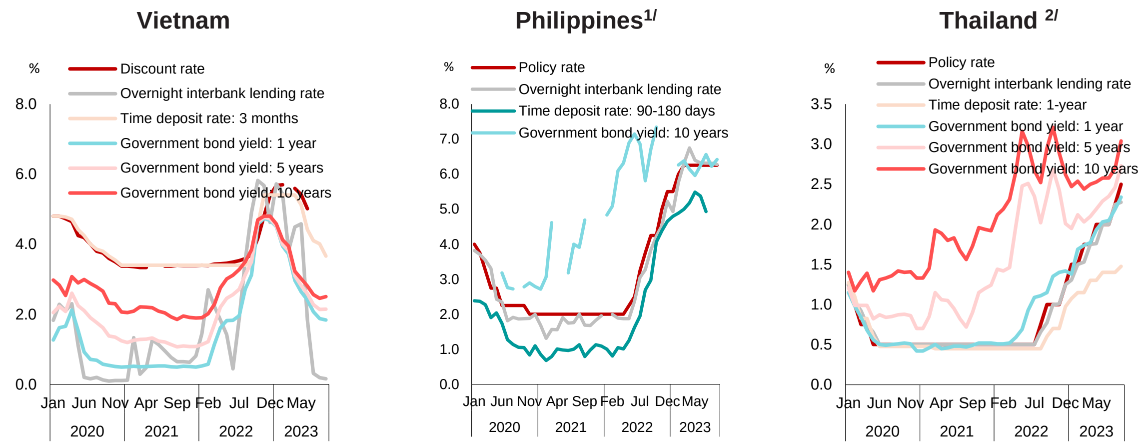
Tools	Definition
Liquidity support by SOCBs	When a joint-stock commercial bank (private commercial bank) encounters financial difficulties, SOCBs would step in to provide special financial assistance to the troubled bank.

Source: SBV Circular No. 42/2015/TT-NHNN and Circular No. 09/2021/TT-NHNN; AMRO staff compilation

Policy Considerations

11. **The rapid development of the Vietnamese economy necessitates a transition toward a more market-based monetary policy regime.** On one hand, Vietnam's economic activities have gradually shifted from a centrally planned economy to a market-based one. Capital markets have developed, and demand for new financial instruments is increasing. On the other hand, despite years of interest rate liberalization, the SBV's operational targets still comprise a combination of quantitative-based measures and are a form of interest rate control. Looking ahead, the current regime is likely to become less and less effective in macroeconomic management with the changing economic and financial landscape, and might unintentionally distort market behaviour, posing challenges to market development. This is evident in the increasing fragmentation of Vietnam's financial markets and the slow progress of derivatives markets. In this context, it is worth considering a gradual phaseout of direct monetary instruments and allowing for market-based policy instruments to play a more significant role (Figure A1.6).

Figure A1.6. Interest Rate Movement and Policy Rate in Selected ASEAN Countries



Source: National authorities

Note: 1/ Bangko Sentral ng Pilipinas (BSP) adopted an interest rate corridor (IRC) system in 2016 to strengthen monetary policy transmission to short-term money market interest rates. Since then, the BSP has constantly refined the system to enhance effectiveness, such as by introducing new absorption tools. During 2022-2023, several important adjustments were also made to improve monetary policy transmission and support market development (AMRO 2023 Annual Consultation Report on the Philippines).

2/ The Bank of Thailand's (BOT) monetary policy instruments comprise reserve requirements, OMOs, standing facilities, a securities borrowing facility, and lending facilities if real-time gross settlement, or the BATHNET, is completely offline. The BOT employs an IRC system to maintain the short-term interest rate in line with the BOT's policy rate (one-day RP transactions).

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