CURRENT EXCHANGE RATES AND MANAGEMENT POLICIES IN VIETNAM

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Received: 19/02/2024
Revised: 21/08/2024
Accepted: 28/08/2024

DOI: 10.59266/houjs.2024.444

Abstract: *In the age of inflation, the monetary policy management of national central banks has been challenging in stabilizing the economy. The exchange rate is an economic variable that affects most of the aspects of the economy's activities, but the effect of the exchange rate on many activities is very different. In particular, the impact of exchange rates on trading activities is clear and quick. Therefore, the majority of countries use the exchange rate as an effective tool to adjust their import and export activities of goods and services. In Vietnam, although the State Bank of Vietnam (SBV) has managed the exchange rate relatively stable, in the coming time, the exchange rate may continue to be under pressure due to high inflation and political conflicts between countries; there are still no signs of ending… Potential risks affecting investment, production – business activities, and the exchange rate fluctuations in the foreign exchange market. Researching and making practical proposals will help the State Bank apply exchange rate regimes and appropriate exchange rate management mechanisms.*

Keywords: *Exchange rate, economy, impact, tool, services management, the state bank, market.*

I. Introduction

Accordingly, the State Bank of Vietnam (SBV) has managed relatively stable exchange rates with major foreign currencies such as USD and Euro, and other countries have significant trade relations with Vietnam to maintain domestic macro stability, support investments, and engage in different economic activities. However, in the coming time, the VND exchange rates may continue to be under pressure as global inflation remains above target for many countries, geo-political tensions, up-scale risks, etc., potentially affecting investment, production, and business activities and the fluctuations in the foreign exchange market. Much research on the exchange rate regimes has become available. *Mishkin, F.S. (2007) The economics of money, banking, and financial markets. Pearson Education, Research on exchange rates and monetary policy: an overview by Jeffery Amato, Andrew Filardo, Gabriele Galati, Goetz von Peter, and Feng Zhu.* In Vietnam, a small number of studies on exchange rates- *Arrow Capital (2023)* and *Bank for International Settlements (BIS) (2023)* have been carried out. Moreover, few studies have investigated the current exchange rates and their management policies in Vietnam.

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II. Literature review

According to different criteria, some types of exchange rates can be named. In terms of the time the exchange rate, the opening and closing rates are introduced, whereas the terms buying or bid rate as opposed to the selling or ask / offer rate are used to demonstrate the trading methods. Regarding the means of transfer, the terms mail transfer (MT), telegraphic transfer (TT), and electronics transfer (ET) are used. As is known, ET is the latest and fastest, while the terms transfer rate and cash rate show the modes of transfer. The entities determining the rate of exchange are the official rate, market rate, and black market rate. The last two terms, spot rate, and forward rate, are used to demonstrate the criterion of transaction terms.

The following exchange rate regimes are introduced according to the extent to which the central bank intervenes in the management of the rate of exchange or, as seen from the national macroeconomic management policy a particular nation opts to practice.

An exchange-rate regime is how an authority manages its currency about other currencies and the foreign exchange market. It is closely related to monetary policy, and the two generally depend on many of the same factors. The basic three types are a floating exchange rate, where the market dictates movements in the exchange rate; a managed float, where a central bank keeps the rate from deviating too far from a target band or value; and a fixed exchange rate, which ties the currency to another currency, mostly more widespread currencies such as the US dollar or the euro or a basket of currencies.

A fixed exchange rate

In a fixed exchange rate system, the monetary authority uses rates of exchange with each other currency. It adjusts the money supply, limiting the exchange transactions and adjusting other variables to ensure the exchange rates do not move. All variations on fixed rates decrease the time inconsistency problem and exchange rate volatility by different degrees. Fixed rates are those that have direct convertibility towards another currency.

A floating or fluctuating exchange rate

It is a type of exchange rate regime in which a currency's value is allowed to fluctuate in terms of the foreign exchange market. A currency that uses a floating exchange rate is known as a floating currency. Floating rates are currently the most common exchange rate regime today. For instance, the dollar, euro, Yen, and British pound are floating currencies.

A managed float rate

These regimes are often called managed float because central banks frequently intervene to avoid excessive appreciation or depreciation. Managed float exchange rates are identified in the foreign exchange market. Authorities intervene but are not bound by any intervention rule, often accompanied by a separate nominal anchor such as the target of inflation. The arrangement provides a way to mix market-determined rates with stabilizing intervention in a non-rule-based system. Its potential disadvantages are that it doesn't constrain monetary and fiscal policy. It can suffer from uncertainty due to reduced credibility, relying on the credibility of financial authorities. Thus, it typically offers limited transparency.

2.1. Framework of monetary policy

The framework of monetary policy and the exchange rate regime is expressed to show the role of the exchange rate in general economic policy and help identify potential sources of inconsistency in the mixture of its policies.

2.1.1. Anchor of Exchange Rate

To keep the exchange rate at its pre-announced level or range, the monetary authority is willing to buy/sell foreign exchange at given quoted rates; the exchange rate plays a crucial role in monetary policy's nominal anchor or intermediate target. This regime comprises exchange rate regimes with no separate legal tender, arrangements of a currency board, fixed pegs with and without bands, and crawling pegs with and without bands.

2.1.2. Monetary Aggregate Anchor

There are some instruments the authority can use to achieve a target growth rate for a monetary aggregate, such as reserve money, which becomes the nominal anchor or the intermediate target of monetary policy.

2.1.3. Framework of Inflation Targeting

The public notification of medium-term numerical targets for inflation and an institutional commitment by the monetary authority to achieve these targets. Moreover, another characteristic is increased communication with the public and the markets about the plans and monetary policymakers' objectives and increased central bank accountability for gaining its inflation objectives. Monetary policies are guided by the deviation of forecasts of future inflation from the target, with the inflation forecast acting (implicitly and explicitly) as the intermediate monetary policy target.

III. Some Exchange Rate regimes and exchange rate management policies in Vietnam

Vietnam is now operating a managed floating exchange rate system, where the State Bank of Vietnam (SBV) plays a crucial role in affecting the exchange rate. The SBV intervenes in the foreign exchange market to ensure the stability of the value of the Vietnamese Dong (VND) against other currencies, particularly the US dollar (USD), which is commonly used for international trade and is a reference currency for a wide range of transactions. Several key points regarding exchange rate management in Vietnam are presented as follows.

3.1. Managed Floating System

While the VND is allowed to fluctuate in the foreign exchange market, the SBV actively intervenes to smooth out excessive volatility and maintain stability. Vietnam operates a managed floating system, a mixture of fixed and floating regimes. In this system, the value of the Vietnamese Dong (VND) is decided by the supply and demand in the foreign exchange market, but the SBV still intervenes to control the fluctuations of currency.

3.1.1. Market Determinants

Under this system, some factors influence the exchange rate of the VND, such as trade flows, capital flows, inflation differentials, and market speculation. The interplay of these forces leads to fluctuations in the exchange rate.

3.1.2. Intervention of SBV

Despite some exchange rate fluctuations, the SBV actively intervenes in the foreign exchange market to smooth out excessive volatility and keep stability. The SBV could buy or sell foreign currency (typically USD) to gain this movement.

3.1.3. Exchange Rate Bands

SBV sets certain bands or ranges within which the VND can fluctuate with some significant currencies such as the US dollar, Yen, or Canadian dollar. If the exchange rate reaches these bands' higher or lower bounds, the central bank may use its power intervention to keep it within the desired range.

3.1.4. Foreign Exchange Reserves Management

Many central banks have very substantial foreign exchange reserves, which can be used to control the foreign exchange market. Frequently, the mere expectation of central bank intervention is sufficient to stabilize a currency, but in case of aggressive intervention, the actual impact on the short-term supply/demand balance can lead to the desired moves in exchange rates.

3.1.5. Policy Objectives

The managed floating exchange rate system allows Vietnam to balance multiple policy objectives. These include promoting export competitiveness, maintaining price stability, attracting foreign investment, and managing external imbalances.

3.1.6. Gradual Adjustment

The SBV may periodically adjust its intervention strategies and exchange rate policies to adjust economic conditions, external shocks, or policy objectives. Overall, Vietnam's managed floating exchange rate system provides flexibility to respond to market dynamics while allowing the central bank to get control over the exchange rate to support economic stability and growth.

3.2. Foreign Exchange Reserves

Foreign exchange reserves are the amount of foreign currency held by a country's central bank or monetary authorities, which is a type of state asset stored in foreign currency for international anticipation or support of the value of the national currency.

Some kinds of foreign exchange reserves are shown in the balance sheet of the state bank, including the state-owned foreign exchange assets assigned by the government to the State Bank for direct management. Foreign currency and gold deposits of credit institutions and foreign bank branches are also known as credit institutions.

3.2.1. Other sources of foreign exchange reserves

Some other forms of reserves with assets include banknotes, deposits, bonds, treasury bills, gold, IMF drawing rights, special drawing rights, SDRs, and securities. Moreover, foreign exchange reserves play a crucial role in operating a country's monetary policy:

When the amount of foreign reserves increases, the State Bank will have a lot of appropriate forms and solutions in operating monetary policy. More importantly, they create convenience in flexible management and stabilize the exchange rate, strengthening the value of Dong. As a result, it increases the beliefs of foreign investors and the public.

A stable foreign exchange market will help foreign investors confidently participate and pour capital into our domestic market. Because they are less likely to worry about the exchange rate risks, simultaneously helping to attract more foreign currency capital and creating more opportunities for the State Bank to increase its foreign exchange reserves. At the same time, they will turn around to help operators have more tools and resources to stabilize exchange rates when necessary. Moreover, a sharp increase in foreign exchange reserves can also help improve Vietnam's future credit rating, especially when its debt payment has increased significantly.

Moreover, the banking system's liquidity remains high thanks to the State Bank's vital purchase of foreign currency and the injection of a corresponding amount of currency into the market. As a result, the interest rate level is relatively stable when liquidity is often under pressure at the end of the year.

3.2.2. Forms of foreign exchange

There are some common forms of foreign exchange data as follows:

Firstly, foreign exchange reserves in cash, balance of foreign currency deposits in foreign banks, gold reserves, and other forms. Secondly, reserves of bonds, bills of exchange, or other debit documents of foreign government banks or international monetary and financial institutions and banks abroad.

With the current renovation, Vietnam operates a managed floating exchange rate system, a hybrid of fixed and floating exchange rate regimes. In this system, the Vietnamese Dong (VND) value is determined by the foreign exchange market's supply and demand forces. Still, the SBV also intervenes to manage the fluctuations of its currency.

3.2.3. Current status and trends in foreign exchange reserve management:

3.2.3.1. Reserve size of foreign exchange reserve management

Vietnam's foreign exchange reserves have seen significant growth in recent years. By the end of 2023, Vietnam's foreign exchange reserves were reported to be around USD 109 billion.

a. Key factors contributing to the growth

Trade surplus in which Vietnam has consistently maintained a trade surplus, driven by strong export growth, particularly in electronics, textiles, and agricultural products. Regarding foreign direct investment (FDI), Vietnam continues to attract substantial FDI, contributing to inflows of foreign currency. With remittances, Vietnam receives many remittances from overseas Vietnamese, which also boosts foreign exchange reserves. One of the other factors is monetary policy. The State Bank of Vietnam (SBV) has taken the initiative to accumulate reserves to ensure financial stability and manage exchange rate fluctuations.

b. Challenges in foreign exchange reserve management

There are some challenges in foreign exchange reserve management. Firstly, fluctuations in global economic conditions can impact export demand and investment flows. Secondly, currency volatility manages the Dong's exchange rate amid global currency fluctuations. Finally, investment returns balance the safety and liquidity of reserves with the need to generate returns. Vietnam's foreign exchange reserves have grown significantly, reflecting the country's strong economic fundamentals. The SBV prudently manages these reserves to support financial stability and growth.

3.2.3.2. Reserve structure of foreign exchange reserve management

The structure of Vietnam's foreign exchange reserves managed by the State Bank of Vietnam (SBV) can reflect a strategic approach to ensure stability, liquidity, and modest returns. While specific detailed breakdowns of the reserve structure are not often publicly disclosed for security and strategic reasons, some typical components can be based on standard practices and available information.

a. Currency Composition

Vietnam's foreign exchange reserves are diversified with several major currencies to mitigate risk and enhance stability. The US Dollar (USD) is the dominant currency, reflecting its global reserve currency status. Euro (EUR) is a significant portion due to Vietnam's trade relations with the Eurozone. Japanese Yen (JPY) is another important currency, given Japan's key trading partner and investor role. Chinese Renminbi (RMB) is increasingly prominent, especially after the RMB's inclusion in the IMF's Special Drawing Rights (SDR) basket. The British Pound (GBP) and Swiss Franc (CHF) are other currencies.

b. Asset Types

Vietnam's foreign exchange reserves are typically held in various asset types to balance safety, liquidity, and returns. The most significant portion is invested in highly liquid and secure government securities, predominantly from the United States, Europe, and Japan. A portion is held as deposits with highly rated international banks to ensure liquidity. Another asset type is that Vietnam maintains some of its reserves in gold as a hedge against inflation and currency risks. Holdings of drawing rights are international reserve assets created by the IMF, adding a layer of stability.

c. Risk management

The SBV carries out some risk management practices to safeguard the reserves. Regarding credit risk, investments are deployed in high-credit-quality tools and corporations to minimize default risk by using liquidity risk to ensure a portion of reserves is readily accessible to meet short-term obligations. Apart from market risk, diversification across currencies and assets is done to manage the impact of market fluctuations.

d. Investment strategies

Vietnam's investment strategies for its foreign reserves include safety and liquidity. They prioritize secure and liquid assets to maintain quick access to funds. Besides yield considerations, safety and liquidity are paramount; there is also a focus on achieving modest returns to support economic objectives. Finally, diversification helps spread investments across different currencies and asset classes to reduce exposure to any single risk.

In short, Vietnam's foreign exchange reserve structure is characterized by a prudent mixture of currencies and assets, some stringent risk management, and alignment with national economic policies. This strategic approach is likely to help safeguard the country's financial stability and support its economic growth objectives.

3.3. Some proposals for exchange rate management by the State Bank

Firstly, adjustments and changes in exchange rate management must be carefully considered and cautiously synchronized with the process of modernizing the monetary policy in the operating framework as well as by the roadmap for liberalization of capital flows of international standards (accompanied by building macroprudential measures) along with the level of capital market development and modernization of the banking system; thereby promoting the effectiveness of monetary policy transmission. The SBV's monetary policy management needs to continue to be steadfast to control inflation, but during the operating process, it is necessary to consider the impacts on financial stability and strengthen the combination with fiscal policy and macroeconomic safety to form an integrated policy framework to enhance monetary autonomy, improve economic and price stability (inflation), and reduce output fluctuations against financial fluctuations and balance sheet risks.

Secondly, The SBV could develop a more diverse foreign exchange market to minimize the risk of exchange rate fluctuations by creating a legal corridor and building a detailed plan to expand the foreign exchange market, especially the trading market. Foreign currency derivative products are to increase the ability to prevent exchange rate risks. It is necessary to popularize and encourage businesses, mainly export and import businesses, to use foreign currency risk prevention measures to minimize large fluctuations in exchange rates in the short term when the market is subject to shocks externally, as well as helping to increase the depth of the foreign exchange market in the long term.

Finally, The SBV should strengthen communication work to stabilize market psychology, especially in periods of volatility to stabilize psychology in the foreign exchange market, thereby improving the reputation of operating monetary policy and increasing the ability to determine the direction and guidance of the foreign currency market.

IV. Conclusion

Exchange rate management policies must evolve based on economic conditions and priority policies. For the most current information on exchange rates and exchange rate management in Vietnam, it is recommended that official sources such as the State Bank of Vietnam or reputable financial news outlets should be referred to.

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TỶ GIÁ VÀ CHÍNH SÁCH ĐIỀU HÀNH TỶ GIÁ HIỆN NAY TẠI VIỆT NAM

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Tóm tắt: *Trong thời đại lạm phát, việc điều hành chính sách tiền tệ của các ngân hàng trung ương các quốc gia gặp nhiều thách thức trong việc ổn định nền kinh tế. Tỷ giá hối đoái là một biến số kinh tế, ảnh hưởng đến hầu hết các mặt trong hoạt động của nền kinh tế nhưng tác động của tỷ giá hối đoái đến nhiều hoạt động là rất khác nhau. Đặc biệt, tác động của tỷ giá đến hoạt động giao dịch là rõ ràng và nhanh chóng. Vì vậy, phần lớn các nước đều sử dụng tỷ giá hối đoái như một công cụ hữu hiệu để điều chỉnh hoạt động xuất nhập khẩu hàng hóa và dịch vụ của mình. Tại Việt Nam, mặc dù Ngân hàng Nhà nước Việt Nam (NHNN) đã điều hành tỷ giá tương đối ổn định, tuy nhiên trong thời gian tới, tỷ giá có thể tiếp tục chịu áp lực do lạm phát cao và xung đột chính trị giữa các nước vẫn chưa có dấu hiệu kết thúc… Rủi ro tiềm ẩn ảnh hưởng đến hoạt động đầu tư, sản xuất – kinh doanh và biến động tỷ giá trên thị trường ngoại hối. Bài nghiên cứu và những đề xuất hiệu quả sẽ giúp Ngân hàng Nhà nước áp dụng chế độ tỷ giá và cơ chế điều hành tỷ giá phù hợp.*

Từ khóa*: Tỷ giá, nền kinh tế, tác động, công cụ, các dịch vụ quản lý, ngân hàng nhà nước, thị trường.*

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