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ABSTRACT

Since the mid-1980s, when Vietnam embarked on a transitional path to a market-oriented economic system, the country’s exchange rate regime has undergone major changes. To what extent have these changes facilitated the pursuit of the authorities’ main policy priorities? How appropriate are the current exchange rate setting arrangements, in light of domestic and international developments? These questions are of potential interest to researchers as well as to policy-makers not only in Vietnam, but also in other developing and transitional economies. Yet they are difficult to answer satisfactorily, partly because of the opaque nature of information about the Vietnamese authorities’ policy objectives and partly because of a relative scarcity of systematic and rigorous studies of these issues in the Vietnamese context.

The purpose of this study is to help address this relative gap in the literature and to provide a better understanding of Vietnam’s exchange rate policy since the late 1980s and its consequences for macroeconomic performance and foreign exchange (forex) market development. In pursuing these objectives, this study employs three methods of analysis: (i) analytical review and synthesis; (ii) econometric analysis; and (iii) questionnaire survey. These different analytical techniques are applied in a complementary and integrated way to provide a broadly-based analysis of different but inter-related aspects of exchange rate policy and the forex market in Vietnam.

The first overall finding of this study is that the Vietnamese authorities apparently preferred a stable nominal VND/USD rate. There were periods when arguably the authorities had little choice but to allow large movements in this bilateral rate. However, whenever such contingencies had passed, the authorities returned to a relatively stable VND/USD rate.

Second, as a consequence of the emphasis on the stability in the bilateral VND/USD rate, the overall value of the country’s nominal effective exchange rate (NEER) as well as real effective exchange rate (REER) has often become an endogenous, rather than policy, variable. The country frequently experienced large losses in external competitiveness, contributing to the country’s trade deficits.
Third, the authorities’ apparent emphasis on stabilizing the bilateral VND/USD rate was not of great assistance in achieving a low and stable inflation rate. This finding is supported by simple statistical analysis and two additional econometric analyses:

(i) As reported in Chapter 5, there is no evidence that “harder peg” exchange rate regimes were associated with lower inflation persistence in Vietnam during the period January 1992 - June 2010. Indeed, the results of formal regressions suggest that “softer peg” periods may have coincided with lower inflation persistence, while the results of rolling regressions indicate that inflation persistence reached its highest level during the sub-period 2004-2007, which is identified as a time of “harder peg”.

(ii) The examination of exchange rate pass-through to inflation using a VAR analysis in Chapter 5 suggests that the movements in the NEER, but not those of the bilateral VND/USD rate, had positive impacts on inflation. This implies that a nominal peg to the US dollar could not prevent pass-through effects of the NEER onto inflation, especially when the anchoring currency (US dollar) is depreciating against other major currencies, as was the case during the years 2001-2009.

Another key finding is associated with the implications of exchange rate policy for the development of Vietnam’s forex market. Following a microstructure approach to the analysis of the root-causes underlying the operational deficiencies of this market, and taking into account findings from surveys of market participants, this study suggests that the authorities’ preference for stability in the bilateral VND/USD rate has resulted, in practice, in an adjustable peg regime which, in turn, has acted as a retardant to the development of Vietnam’s forex market. Consequently, market signals have become increasingly non-transparent. There are indications that market forces often moved beyond the framework of the prevailing regulations in the latter years of the study period.

The main contribution of this study is that it combines different methods of analysis in a single work to provide a consistent picture of Vietnam’s exchange rate policy since the late 1980s and its consequences for macroeconomic performance and forex market
development. Though each method has its limitations, they are adopted in a complimentary and integrated manner, helping us to gain useful insights into various aspects of Vietnam’s exchange rate policy.
STATEMENT OF AUTHORSHIP

This work has not previously been submitted for a degree or diploma in any university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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TRAN-PHUC NGUYEN

February 2012
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<th>Description</th>
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<tbody>
<tr>
<td>ACB</td>
<td>Asian Commercial Bank</td>
</tr>
<tr>
<td>ADF</td>
<td>Augmented Dickey Fuller</td>
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<td>AFTA</td>
<td>ASEAN Free Trade Area</td>
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<td>Agribank</td>
<td>Vietnam Bank for Agriculture and Rural Development</td>
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<td>AIC</td>
<td>Akaike information criterion</td>
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<td>AR</td>
<td>Autoregression</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<tr>
<td>BIDV</td>
<td>Bank for Investment and Development of Vietnam</td>
</tr>
<tr>
<td>BIS</td>
<td>Bank for International Settlements</td>
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<tr>
<td>CIF</td>
<td>Cost, insurance and freight</td>
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<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>CNY/USD</td>
<td>Exchange rate between CNY and USD defined as the price of USD in terms of CNY</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer price index</td>
</tr>
<tr>
<td>CV</td>
<td>Coefficient of variation</td>
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<td>CZK</td>
<td>Czech Koruna</td>
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<tr>
<td>CZK/EUR</td>
<td>Exchange rate between CZK and EUR defined as the price of EUR in terms of CZK</td>
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<tr>
<td>Doi Moi</td>
<td>In Vietnamese, referring to the renovation program launched in the mid 1980s</td>
</tr>
<tr>
<td>ECB</td>
<td>European Central Bank</td>
</tr>
<tr>
<td>EMH</td>
<td>Efficient Market Hypothesis</td>
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<tr>
<td>EMS</td>
<td>European Monetary System</td>
</tr>
<tr>
<td>ERM</td>
<td>European Exchange Rate Mechanism</td>
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<td>EUR</td>
<td>Euro</td>
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<tr>
<td>Eximbank</td>
<td>Vietnam Export Import Commercial Joint Stock Bank</td>
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<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
</tr>
<tr>
<td>Fed</td>
<td>Federal Reserve System – the central banking system of the United States</td>
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<tr>
<td>FOB</td>
<td>Free on board</td>
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<tr>
<td>Forex</td>
<td>Foreign exchange</td>
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<td>FPE</td>
<td>Final prediction error</td>
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<td>GBP</td>
<td>Pound sterling</td>
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<td>Acronym</td>
<td>Description</td>
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<tr>
<td>GDP</td>
<td>Gross domestic production</td>
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<td>GSO</td>
<td>Vietnam’s General Statistics Office</td>
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<tr>
<td>HCM City</td>
<td>Ho Chi Minh City</td>
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<tr>
<td>HP</td>
<td>Hodrick Prescott</td>
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<td>HQC</td>
<td>Hannan-Quinn information criterion</td>
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<td>IFS</td>
<td>International Financial Statistics</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IRF</td>
<td>Impulse response function</td>
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<td>JPY</td>
<td>Japanese Yen</td>
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<tr>
<td>JPY/USD</td>
<td>Exchange rate between JPY and USD defined as the price of USD in terms of JPY</td>
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<tr>
<td>KPSS</td>
<td>Kwiatkowski–Phillips–Schmidt–Shin</td>
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<tr>
<td>LM</td>
<td>Lagrange multiplier</td>
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<tr>
<td>LR</td>
<td>Sequential modified likelihood ratio test statistic</td>
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<td>NEER</td>
<td>Nominal effective exchange rate</td>
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<tr>
<td>OCA</td>
<td>Optimum Currency Area</td>
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<tr>
<td>ODA</td>
<td>Official development assistance</td>
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<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<tr>
<td>OLS</td>
<td>Ordinary Least Squares</td>
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<tr>
<td>PLN</td>
<td>Polish Zloty</td>
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<tr>
<td>PLN/EUR</td>
<td>Exchange rate between PLN and EUR defined as the price of EUR in terms of PLN</td>
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<tr>
<td>PP</td>
<td>Phillips-Perron</td>
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<tr>
<td>REER</td>
<td>Real effective exchange rate</td>
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<tr>
<td>RMA</td>
<td>Recursive mean adjustment</td>
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<tr>
<td>RMSPE</td>
<td>Root mean square percentage error</td>
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<tr>
<td>RQ</td>
<td>Research question</td>
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<tr>
<td>SER</td>
<td>Standard error of the regression</td>
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<td>SBV</td>
<td>State Bank of Vietnam</td>
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<td>SCI</td>
<td>Schwarz information criterion</td>
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<tr>
<td>SD</td>
<td>Standard deviation</td>
</tr>
<tr>
<td>SKK</td>
<td>Slovak Koruna</td>
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<tr>
<td>SKK/EUR</td>
<td>Exchange rate between SKK and EUR defined as the price of EUR in terms of SKK</td>
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<tr>
<td>SOE</td>
<td>State-owned enterprise</td>
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<tr>
<td>SWIFT</td>
<td>Society for Worldwide Interbank Financial Telecommunication</td>
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<tr>
<td>Symbol</td>
<td>Definition</td>
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<tr>
<td>THB</td>
<td>Thai baht</td>
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<tr>
<td>THB/USD</td>
<td>Exchange rate between THB and USD defined as the price of USD in terms of THB</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
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<tr>
<td>US</td>
<td>United States</td>
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<tr>
<td>USD</td>
<td>United States Dollar</td>
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<tr>
<td>USD/GBP</td>
<td>Exchange rate between USD and GBP defined as the price of GBP in terms of USD</td>
</tr>
<tr>
<td>USD/VND</td>
<td>Exchange rate between VND and USD defined as the price of VND in terms of USD</td>
</tr>
<tr>
<td>VAR</td>
<td>Vector Autoregressive/Vector Autoregression</td>
</tr>
<tr>
<td>VDS</td>
<td>Vietnamese dong dealing system provided by Telerate</td>
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<tr>
<td>VEC</td>
<td>Vector Error Correction</td>
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<tr>
<td>Vietcombank</td>
<td>Bank for Foreign Trade of Vietnam</td>
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<tr>
<td>VND</td>
<td>Vietnamese Dong</td>
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<tr>
<td>VND/EUR</td>
<td>Exchange rate between VND and EUR defined as the price of EUR in terms of VND</td>
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<tr>
<td>VND/USD</td>
<td>Exchange rate between VND and USD defined as the price of USD in terms of VND</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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