

Vietnam is following the Asian Tiger currency formula for rapid economic growth

In April, 2016 Vietnam installed its youngest-ever governor of the State Bank of Vietnam (SBV), the 45-year-old Le Minh Hung (now 47). A Japanese-educated economist with close connections to the IMF and Asian Development Bank, Hung seems to be on a mission to build the SBV's foreign currency reserves. Sitting at a then-record \$40 billion when he took office, Hung has since built the SBV stockpile to nearly \$55 billion at the end of last week.

Hung's success comes on the back of three small devaluations in 2015 that had raised fears of further declines and prompted ordinary Vietnamese to hoard US Dollars as a hedge. Dollarization is potentially damaging to a developing economy because it sterilizes much-needed investment capital while at the same time limiting policy flexibility.

The SBV seems to be taking advantage of the devalued Dong to buy Dollars on the bounce. With the Vietnamese economy booming and foreign investment pouring in, the Vietnamese Dong faces strong upward pressure. A politically weak central bank might cave into political pressure to let the currency rise. Hung deserves credit for leveraging the opportunity to improve the SBV's reserve position instead.

Building reserves is the right course for an export-oriented economy like Vietnam. Japan and the four Asian tigers (South Korea, Taiwan, Hong Kong, and Singapore) pursued the same strategy in their periods of rapid growth. And then there's China.

China let its currency slide throughout the first fifteen years of the reform era, a time when it experienced rapid but volatile growth. But on January 1, 1994 China made one big, final devaluation to shift the Renminbi from an

overvalued to an undervalued position. The People's Bank then let the currency slowly but consistently appreciate for the next twenty years as it built up a \$4 trillion reserve position, the largest the world has ever seen.

A reputation for a stable and slowly appreciating currency is the best asset a developing country can have. It attracts foreign investors by giving them confidence to invest for the long term with the assurance that they can always get their money out at a later date. It also persuades local investors to keep their money inside the country rather than send it abroad for safety.

A stable but consistently undervalued currency has the extra bonus that it acts like a pro-poor progressive income tax. It penalizes the rich people who disproportionately buy imported goods while sparing the poor, whose consumption consists almost entirely of local products like food and shelter.

A low-currency strategy for export-oriented growth is extraordinarily easy to implement, at least from a technical point of view. All the disciplined central banker has to do is sell the currency whenever it looks likely to strengthen.

Most developing countries fail because wealthy constituents prefer a strong currency — so they can buy imported luxury goods, take overseas vacations, and get their money out of the country at the best possible rate. That chokes off growth and generates instability. Countries with overvalued currencies ultimately find themselves calling on the IMF for emergency funds when the bubble inevitably bursts.

If Le Minh Hung and the SBV are able to stay the course with an undervalued but slowly appreciating currency for twenty or even thirty years, Vietnam has every chance to become the long-awaited fifth Asian tiger. With China stagnating at middle-income levels, Vietnam could surprise everyone to leapfrog ahead by mid-century. That's not a prediction, but it is a possibility. The pace of change in Asia is legendary, and Vietnam is increasingly the country setting the pace.

Salvatore Babones

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