

Chapter 3: Practical Steps toward Promoting the Use of the Japanese Yen for Trade Finance in Vietnam

Following the outcomes of the FY2004 research project “Study on Extending Yen-Denominated Trade Finance to Vietnamese Exporters to Japan” commissioned by the Ministry of Finance of Japan to the Institute for International Monetary Affairs (“IIMA”), the IIMA has provided technical assistance to the Socialist Republic of Vietnam (“Vietnam”) under the FY2005 research project “Promotion of the Use of the Japanese Yen for Trade Finance in Vietnam” commissioned by the Ministry of Finance of Japan to the IIMA, with a view to materializing pilot transactions of yen trade finance for Vietnamese enterprises. This chapter reviews the activities of the FY2005 research project and examines the outcomes.

1. Preparatory process for the FY2005 research project

The IIMA was commissioned in 2004 by the Ministry of Finance of Japan to conduct the research project for the FY2004 entitled “Study on Extending Yen-Denominated Trade Finance to Vietnamese Exporters to Japan.” The project focused on studying the feasibility of financial scheme on commercial basis (i.e. without any official support) in which Japanese banks in Vietnam provide with yen funds to Vietnamese commercial banks which in turn extend yen trade finance to Vietnamese exporters/importers. In the course of conducting the feasibility study, a number of parties participated in several meetings both formal and informal. Such parties included from the Vietnamese side the State Bank of Vietnam (“SBV”), the Ministry of Planning and Investment, the Ministry of Finance and the Ministry of Trade, state-owned commercial banks, joint stock banks, and exporters and importers; and from the Japanese side the Ministry of Finance of Japan, the Japan Bank for International Cooperation, Japanese banks in Vietnam and the IIMA.

The FY2005 research project “Promotion of the Use of the Japanese Yen for Trade Finance in Vietnam” has been intended to capitalize on the outcomes of the FY2004 research project. In order to have preliminary discussion on the FY2005 project with Vietnam, the IIMA visited Hanoi to meet with the International Cooperation Department (“ICD”) of the SBV in early September 2005. At the meeting, the IIMA proposed, in response partially to the requests made by the SBV at the final meeting of the FY2004 research project, that the activities under the FY2005 research project should cover within its basic framework the following points: (i) the IIMA and the SBV co-chair a working group to be formed with members from the relevant key Japanese and Vietnamese institutions; and (ii) the working group conducts a case study to review overall operational workflows of export and import transactions in Vietnam with a view to identifying operational issues relating to trade finance and settlement in general and any technical issues arising from using Japanese yen in trade finance and settlement instead of other currencies.

The ICD responded that it would have to carefully review the IIMA’s proposal, as the ICD would need not only to coordinate with the other SBV’s departments concerned and subsequently clear the Governor’s approval, but also to discuss the matter with the relevant Vietnamese ministries such as the Ministry of Finance and the Ministry of Trade. The ICD, however, indicated at the meeting its tentative comments as follows: (i) given the very limited use of the Japanese yen by Vietnamese enterprises, there would be little need for yen trade finance in Vietnam; and (ii) the project would meet to Vietnamese actual needs more effectively if it focused on capacity building for Vietnam in

such areas as foreign exchange risk management, use of hedging instruments, and introduction of best practices of Japan and other foreign countries in this regard.

After subsequent several discussions between the IIMA and the SBV in the following months, the both parties agreed on the basic framework of the new project that was broadly in line with the initial IIMA's proposal made in September. The IIMA, in consultation with the Ministry of Finance of Japan submitted to the SBV an official letter describing the details of the proposal of the FY2005 research project. The SBV accepted the IIMA's proposal in late November, which paved the way to the official start of the FY2005 research project.

2. Launching Meeting

The Launching Meeting was held at the SBV on December 9, 2005. The meeting was attended from the Vietnamese side by the SBV, state-owned commercial banks, joint stock banks, the Ministry of Trade, the Ministry of Finance and state-owned enterprises, and from the Japanese side by the IIMA and Japanese banks in Vietnam.

The meeting started with the opening remarks by the SBV, in which the SBV briefly reviewed the activities and outcomes of the FY2004 research project, and expressed its desire to see further progress under the 2005 project such as materialization of pilot transactions of yen trade finance.

Following the opening remarks by the SBV, the IIMA made a presentation in which the IIMA proposed to form a working group, comprising of the IIMA, the SBV, state-owned commercial banks, joint stock banks and Vietnamese exporters/importers, with a view to: (i) identifying problems of export/import transactions relating to trade finance in Vietnam in general, and finding solutions thereto; (ii) identifying problems relating to trade finance in Vietnam arising from using Japanese yen in export/import transactions, and finding solutions thereto; and (iii) pursuing the possibility of materializing actual transaction of yen trade finance in Vietnam.

In response to the IIMA's presentation on the proposed FY2005 research project, the SBV emphasized that Vietnamese businesses would benefit from yen trade finance in the following points:

- It will diversify financial tools available to Vietnamese exporters/importers;
- It will improve foreign exchange risk management skills of Vietnamese businesses including financial institutions with the Japanese yen being added to transaction currencies along with the Vietnamese dong and the US dollar;
- It will improve trade finance workflows for Vietnamese enterprises; and
- It will promote trade between Vietnam and Japan.

The SBV, based on the above arguments, proposed that the FY2005 research project should focus on: (i) materializing pilot transactions of yen trade finance; (ii) formulating workflows of yen trade finance; and (iii) identifying problems of yen trade finance through pursuing the implementation of pilot transactions, and finding solutions thereto. It also proposed to establish a working group as a task force team for the project.

After the subsequent discussion at the meeting between the IIMA and the SBV, it was agreed that the FY2005 research project should broadly follow the SBV's proposal and the activities should focus on pursuing materialization of pilot transactions of yen trade finance, and identifying problems arising from the pilot case and finding solutions thereto.

The IIMA was requested at the meeting by the SBV to select participating Japanese bank(s) and to

intervene in the negotiation process of the terms and conditions applicable to the yen loan(s) to be extended by participating Japanese bank(s) to Vietnamese bank(s). The IIMA, however, made it clear that the IIMA did not want to get involved in the selection process of participating Japanese banks as it intended to treat all the three Japanese banks in Vietnam at arm's length and to keep them informed of each development at the working group. It also made it clear that the terms of the transactions should be directly negotiated between the participating Japanese and the Vietnamese banks. The SBV understood and accepted the IIMA's position.

The SBV, emphasizing that yen trade finance transactions would need to be cost effective, stated in this connection that the project would also provide an opportunity to enlighten Vietnamese businesses including commercial banks in respect of cost comparison between financial terms including foreign exchange derivatives (e.g. forward contract) and to improve their risk management capabilities. The IIMA, in response to the SBV's request, stated that it would be ready to cooperate with the SBV by organizing a seminar or workshop on foreign exchange derivatives.

3. Activities of the Working Group

(1) The first meeting of the Working Group (held in late December 2005)

Following the Launching Meeting on December 9, the Working Group was formed between the SBV and the IIMA, and its first meeting was held in late December to discuss how to proceed with pilot transactions. The meeting was attended by the SBV and the IIMA, as the Working Group's members, and by the Vietnam Chamber of Commerce and Industry ("VCCI"), the Bank for Foreign Trade of Vietnam (Vietcombank, "VCB"), Agribank and VIETBID (local consulting company), as observers.

The VCB expressed their concerns about the difficulties of materializing pilot transaction of yen trade finance indicating that, given their clients were currently satisfied with finance in the US dollar there would be no incentives for them to use yen trade finance unless the yen financing package included official support such as interest rate subsidy and credit enhancement .

The IIMA clarified that the pilot transactions were intended as pure commercial deals that would not involve official support of any kind, and that the participating Japanese banks were to take the credit risks of the participating Vietnamese banks while the participating Vietnamese banks were to take the credit risks of participating Vietnamese enterprises. In response to the concerns expressed by the VCB about the difficulties of materializing pilot transactions, the IIMA argued that the concerns would appear irrelevant at least with regard to existing export transactions denominated in the Japanese yen. The IIMA's argument was based on the following. The share of yen denominated trade transactions as percent to total Vietnamese trade is estimated at around 5%, indicating that there exist Vietnamese enterprises that are already engaged in yen denominated trade transactions. The pilot transaction should aim at encouraging such enterprises to finance existing yen denominated trade transactions in the Japanese yen, not at encouraging Vietnamese enterprises in general to switch the denomination of trades from the US dollar (or other non-Japanese yen foreign currency) to the Japanese yen. If Vietnamese exporters use the Japanese yen to finance their yen denominated exports, they should be able to benefit from low interest rate of the Japanese yen, without being exposed to foreign exchange risk, as the exporters would be able to repay the borrowed money of yen trade finance by using the export proceeds in the Japanese yen to be received from Japanese importers. Such merit of yen trade finance, however, is not straightforward for yen denominated imports, as the

importers would be exposed to foreign exchange risks when they borrow in the Japanese yen to import goods from Japan to be sold in Vietnamese market in the Vietnamese dong. The importers need to compare financing cost on all-in basis including hedging cost before they decide on whether yen trade finance is more attractive than dollar or dong finance. Nevertheless, it should be noted that Vietnamese importers are going to have an additional financial option (i.e. yen finance) they can use for their imports. The IIMA, reiterating high feasibility of pilot deals, in particular for export transactions for the reason mentioned above, emphasized that the project should start with preparing a short list of enterprises that have already been engaged in yen denominated trade transactions. The Vietnamese side agreed to this approach.

The IIMA and the SBV agreed at the meeting that, in order to materialize pilot transactions, the following steps needed to be taken: (i) identifying enterprises that have already been engaged in yen denominated exports or imports; (ii) selecting participating Vietnamese bank(s); and (iii) starting bilateral talks between the relevant Vietnamese and Japanese banks. The IMA and the SBV also agreed that that they would meet again in early January 2006.

(2) The second meeting of the Working Group (held in early January 2006)

The IIMA and the SBV attended the meeting, at which the following points were discussed.

- The SBV announced that the VCB had been selected as the Vietnamese participating bank for pilot transaction(s), citing the reason for the selection that the VCB fully understood the background of the project and is a leading Vietnamese commercial bank in trade finance with strong credit standing. Accordingly, the VCB joined the Working Group as an official member.
- In reply to the IIMA's inquiry, the VCB indicated that the assumed size of the pilot transactions would be Japanese yen equivalent to approximately US\$200,000 for a finance period of one to two months.
- As to the participating Japanese bank(s) in pilot transaction(s), the IIMA strongly recommended that it would be desirable that all Japanese banks in Vietnam should be invited to the project by the Vietnamese participating bank, namely VCB, and that, even if the VCB had to reduce the number of participating Japanese banks at later stage due to limited number of pilot transactions, there would be no merits in attempting to narrow down the number of participating Japanese banks at this stage, in particular before the VCB started bilateral talks with each of the Japanese banks in Vietnam. The SBV and the VCB indicated that they would follow the IIMA's recommendation.
- The IIMA, the SBV and the VCB agreed that (i) the IIMA would inform the Japanese banks in Vietnam of the SBV's decision on selecting the VCB as the Vietnamese participating bank and of the VCB's acceptance, together with the information on the assumed size and term of pilot transactions; (ii) the IIMA would feed back to the SBV and the VCB about each Japanese bank's response to (i) above; and (iii) the IIMA, the SBV and the VCB would meet again thereafter to discuss how to proceed with bilateral talks between the VCB and each of the Japanese banks.

(3) Bilateral talks between the VCB and the Japanese banks

As agreed between the members at the second meeting of the Working Group, the IIMA visited all the three Japanese banks in Vietnam, namely, The Bank of Tokyo-Mitsubishi UFJ, Ltd., Mizuho Corporate Bank, Ltd., and Sumitomo Mitsui Banking Corporation (in alphabetical order) to inform

them separately of (i) above. All three Japanese banks indicated separately that they would positively consider their participation in the project. The IIMA reported to the SBV and the VCB about the Japanese banks' positive responses. The IIMA recommended the VCB should start bilateral talks with each of the Japanese banks as soon as possible, adding that the IIMA was willing to provide the VCB with necessary support to expedite the process.

The Working Group initially envisaged that the bilateral talks between the VCB and the Japanese banks would have started in late January before Vietnamese new-year holidays (the Tet). However, the bilateral talks took place after the Tet in the second week of February, as the VCB needed more time to go through internal procedures than it had anticipated. The discussion points at each bilateral talks included standby lines for the VCB for yen funds to be extended by each of the Japanese banks and hedging foreign exchange arrangements. As the bilateral talks were part of negotiation process for subsequent commercial deal between the VCB and each of the Japanese banks, the IIMA was not involved in the process.

In mid-February, the IIMA was informed by the VCB that the VCB and each of the three Japanese banks in Vietnam agreed in principle on the arrangement between them with regard to yen funds, and that the VCB would move as a next step toward starting negotiations with potential customers with a view to materializing pilot transactions.

(4) Bilateral negotiations between the VCB and its customers

In parallel with the bilateral talks with the Japanese banks in Vietnam, the VCB conducted extensive internal discussion about the yen trade finance schemes (e.g. financing structure, workflows, terms and conditions) that would be proposed to customers. In early March, a draft report was presented to the VCB's Board of Management. Further internal discussions were conducted among the departments concerned at the VCB (i.e. Financial Institutions Department, Corporate Banking Department, Trade Finance Department, Credit Risk Management Department, Export Payment Department, Import Payment Department and Treasury Department) to fine-tune their financial schemes. At the meeting among the departments concerned held in mid-March, the VCB officially agreed on the financial schemes of the yen trade finance covering pre-export financing, export bill negotiation, and import financing together with the relevant workflows.

After the board's approval, the VCB started official negotiations with potential customers with strong credit standing. In fact the VCB had already had preliminary discussions with such clients, as they had previously shown to the VCB their basic interest in yen trade finance. As is mentioned later in this report, a workshop on yen trade finance was held for the VCB's clients in the week of the Final Meeting held on March 21.

The IIMA, while paying due attention to confidentiality obligation, supported the VCB in their preparing for bilateral negotiations process. Such support included providing advice and information to the VCB on deal structure of yen trade finance and yen financing cost on all-in basis in comparison to other financings.

4. Seminar on foreign exchange derivatives

The IIMA and the SBV jointly organized a seminar on foreign exchange derivatives on March 21 morning with a view to improving foreign exchange risk management skills of Vietnamese businesses in particular banking institutions as it should be indispensable in utilizing yen trade finance.

The seminar was attended by the representatives from four state-owned commercial banks and four joint stock banks.

The IIMA's presentation focused on foreign exchange forward contracts and currency options, giving explanations on (i) how such derivatives' mechanisms work, (ii) how exporters or importers can make use of them, and (iii) how spot, forward and option markets are inter-related through arbitrage transactions and why the spot and forward markets need to be functioning effectively to make option market develop properly.

The SBV's presentation focused on Vietnam's current regulatory situation of foreign exchange derivatives, giving explanations by product (e.g. forward contract, options) as to restrictions, approval procedures and reporting requirements applicable to each of the derivatives. The SBV emphasized it had been steadily deregulating restrictions to promote the use of foreign exchange derivatives in Vietnam.

In answering the question from the audience as to the level of hedging cost of the Japanese yen and the Vietnamese dong, the IIMA admitted its rather high cost level, but explained that, should the size of foreign exchange transactions between the Japanese yen and the Vietnamese dong increase, the cost would be expected to decline eventually, and that, should Vietnam revise the current de facto US dollar-pegged Vietnamese dong foreign exchange system and make it more flexible one, more foreign transactions between the Japanese yen and the Vietnamese dong would be expected to take place in the market, which would result in reduced hedging cost between the two currencies.

5. Final Meeting

While the VCB had yet to negotiate pilot transaction(s) with potential customers, the Final Meeting was held on March 21 afternoon to receive reports from the members of the Working Group on their activities under the FY2005 research project and discuss the outcomes. The meeting was co-chaired by the SBV and the IIMA, and was attended by other officials from the SBV and the representatives from the VCB, the relevant Vietnamese ministries and the three Japanese banks in Vietnam.

(1) Opening remarks by the SBV as the co-chair of the meeting

The cooperative relations between Vietnam and Japan are reflected in three areas, namely ODA, Japanese foreign direct investment ("FDI") into Vietnam and trade relations between the two countries. In terms of ODA, Japan has consistently been the largest provider, followed by the World Bank Group and the Asian Development Bank. Japan has also been one of the three largest FDI investors into Vietnam. As for trade, the volume between the two countries reached a record high of US\$7 billion in 2005. Despite such close relationships between the two countries, the use of the Japanese yen in trade transactions has been quite limited. This raised two questions: (i) Why the Japanese yen has not been so popular in Vietnam? (ii) How we can promote the use of the Japanese yen in trades between Vietnam and Japan?

In 2004, the SBV and the IIMA conducted a research on the use of the Japanese yen in Vietnam, and interviewed banks and businesses. Banks we interviewed generally responded that the use of the Japanese yen would be feasible but indicated that it would depend on trade contracts between importers and exporters in the two countries. Vietnamese enterprises interviewed by us responded, however, that they would be reluctant to use the Japanese yen, indicating their past experience of

large fluctuation of Japanese yen exchange rate and resulting adverse effects on their imports denominated in Japanese yen. The 2004 research project concluded that further research need to be conducted through pilot transactions.

Yen denominated trade finance facility is a commercial instrument with natural hedging effect. In the context of under-developed forex derivative markets in Vietnam, this facility will provide an additional hedging tool in addition to other conventional hedging instruments. By using the Japanese yen in trade finance activities, it would be expected that Vietnamese businesses would obtain more hedging skills.

The SBV expects this meeting will provide an excellent opportunity to help Vietnamese businesses understand the advantages of using the Japanese yen in commercial activities in general and trade finance in particular. The presentations made by the members of the Working Group will illustrate progress of the project.

(2) Presentations by the IIMA, the SBV and the VCB

The outlines of the presentations by the IIMA, the SBV and the VCB are as follows:

<1> The IIMA's presentation "Promotion of the Use of the Japanese Yen for Trade Finance in Vietnam 2005-2006"

The IIMA emphasized the following points as advantages for Vietnam of using yen trade finance: (i) Using the Japanese yen to finance export/import contract denominated in Japanese yen will be a natural hedge against foreign exchange risk and reduce interest payment cost; (ii) It will provide major Vietnamese banks with additional financial products, thus enhancing banks' ability to meet potential needs of their clients; (iii) It will facilitate major Vietnamese banks to improve their institutional capacity, and eventually strengthen their position in international financial market; (iv) It will diversify financial tools available to Vietnamese exporters and importers; (v) It will improve foreign exchange risk management skill of Vietnamese businesses with the Japanese yen being added to transaction currencies along with the Vietnamese dong and the US dollar; and (vi) It will promote trade between Vietnam and Japan, and enhance further economic ties between the two countries.

The IIMA, referring to the changing economic and financial environments in several Asian countries (e.g. moves to managed float system by China and Malaysia) and increasing trend of regional cooperation among the East Asian countries in coordinating foreign exchange rate policies, pointed out that Vietnam would need to follow up such developments in the region, and that Vietnam would eventually find it useful and necessary to add the Japanese yen to its transaction currencies along with the Vietnamese dong and the US dollar. The yen trade finance would provide Vietnam with a good opportunity to make steady progress in this regard.

The IIMA, in its slide presentation, detailed the deal structure of yen trade finance, and explained the exporters of yen denominated trade contracts would not be exposed to the Japanese yen versus Vietnamese dong exchange rate risk and would therefore secure low interest rate of the Japanese yen without hedging cost.

The project development since the Launching Meeting on December 9 was also reported by the IIMA, in particular the bilateral talks between the three Japanese banks in Vietnam and the VCB. The IIMA made a special mention in this connection on the three Japanese banks' accommodative

stance with respect to yen funds for the pilot transactions to come, adding that the IIMA hoped that all three Japanese banks would be able to participate in the transactions.

<2> The SBV's presentation "Implementation of Pilot Yen Denominated Trade Finance Transactions 2005 Project"

After the SBV stated the 2005 project had planned to select banks and customers to join the pilot transaction, to realize one to two pilot transactions, to identify problems and solutions for Vietnamese banks and exporters and importers, and to transfer know-how and techniques in dealing with derivatives for hedging purpose, it listed the following points as the project's outcomes: (i) a creditworthy bank had been selected to conduct the pilot transactions; (ii) negotiations between the participating bank and Japanese banks had been completed successfully; (iii) a scheme of the new product named as "yen-denominated trade finance product" had been prepared; (iv) a list of potential customers had been made; (v) a workshop between the VCB and its potential customers would be held; (v) most important features of transaction with importers and exporters had been designed by the VCB.

The SBV, on the other hand, cited the following as the challenges which Vietnam had encountered: (i) unexpected problems in preparing new and complete scheme for yen denominated trade finance facility at the VCB in terms of workload and timeframe; and (ii) difficulties in identifying customers with potential needs to use yen finance for their yen denominated commercial contracts (although 1% of total Vietnamese external payment transactions are denominated in the Japanese yen, it was not easy for Vietnamese banks, even a big bank like the VCB, to find the right targeted customers.) The SBV stated that, although pilot transactions were unlikely to be materialized before the current project would expire toward the end of March, it would undertake to see to it that the VCB would pursue the materialization of the pilot transactions thereafter.

The SBV ended its presentation by expressing its expectations for the phase after the current project, in particular the prospects for broadening the base of yen trade finance in terms of both participating Vietnamese banks and enterprises.

<3> The VCB's presentation on "Promotion of Trade Finance in the Japanese Yen: a Pilot Case with Vietcombank"

The VCB summarized the developments of the project at the bank as follows: (i) the VCB was officially selected by the SBV for pilot transactions and became a member of the Working Group; (ii) bilateral negotiations with the individual Japanese banks for yen financing; (iii) constructing the scheme of the yen trade finance for customers; (iv) bilateral negotiations between the VCB and its customers; and (v) holding a workshop for the VCB's customers. The VCB reported process (iv) above was more difficult than they had expected, as yen trade finance was totally new financial product for the VCB's customers and the customers were not readily willing to accept yen trade finance. As such, the internal process to develop new products became more time-consuming than they had anticipated, the VCB cited. (The author of this report would guess the reason for such time-consuming process within the VCB might be that, given the high volatility of the Japanese yen versus the Vietnamese dong exchange rate compared with stability of the exchange rate between the US dollar and the Vietnamese dong, changing the denomination of trade finance from the US dollar to the Japanese yen would require the VCB to make radical changes to the bank's whole business

process of trade finance.) The VCB stated that it would continue its ongoing efforts to reach basic agreement on the pilot transactions promptly and expressed its desire for the continued supports to the VCB from the SBV, the IIMA and the Japanese banks.

(3) Question and answer session

Following the presentations by the SBV, the IIMA and the VCB, the floor was open to question and answer. The following comments and remarks were made during the Q&A session.

The IIMA commented that the institute was prepared to provide the VCB with its continued support to the materialization of the pilot transactions from Tokyo by e-mails, although the current project would be expiring toward the end of March.

The SBV commented as follows. One of the most important factors deciding on the current limited use of the Japanese yen in Japan-Vietnam trade financing is the big fluctuation of Japanese yen exchange rate in the past, causing many Vietnamese trading companies and financing banks then to double their indebtedness. That phenomenon brought in the relevant companies' painful psychological effect that long-lasting up to now that many companies are still reluctant to use the Japanese yen. Given the above, the following should be addressed. First, the financial advantage of using the Japanese yen, with new developments in Vietnamese operating environment (namely, increased trade between Japan and Vietnam; improved legal framework in foreign exchange derivatives and enhanced capacity of banks in this field), needs to be proved evidently. This can be shown by the result of pilot transactions in the Japanese yen in which the participating companies can compare the result of using the Japanese yen with that of using the US dollar. The overall advantage of using the Japanese yen will be decided by the combination of the interest rate of the Japanese yen which is quite low at the moment and the cost for foreign exchange hedging instrument. Secondly, if and when the financial advantage of using the Japanese yen, through the result of the pilot transactions, shall have been evidenced, the next step should be focusing on persuading customers on the proved advantages so that they could overcome the psychological effect of using the Japanese yen in the past and change their mind. With that aim, the SBV expects that Vietcombank could soon complete its deals of pilot transactions successfully.

The VCB commented as follows. The VCB started meetings with its customers right after it was selected as the participating pilot bank by the SBV. Generally, their feedback is positive. However, customers all are cautious on hedging products since they are worried about the fluctuation of the exchange rate of the Japanese yen versus the Vietnamese dong. In order to persuade customers, the VCB is also offering to provide them with arrangement to protect against such risk. The VCB expects the customer to take into account such protection mechanism, though they need some more time to examine the benefit if they accept VCB's proposed financial scheme.

The SBV wrapped up the question and answer session as follows. "The SBV believes all the presentations made so far have provided the participants with clear understanding of the project. The VCB has explained the challenges in realizing the pilot transaction. But, most of the basic elements for the transaction have already been in place. The SBV will follow up closely the negotiation and agreement process between the VCB and its customers. The SBV and the VCB will stay committed to the realization of the pilot transaction. The SBV will work closely with the VCB on this matter and will keep the IIMA posted of any progress of the pilot transactions."

(4) Closing remarks by the IIMA as the co-chair of the meeting

The IIMA delivered the closing remarks for the Final Meeting as follows. “When the preparatory work for the project on pilot transaction started in December last year, we hoped that the parties concerned, namely Vietnamese bank and traders, and Japanese banks would reach agreement in principle on a couple of pilot transactions of yen trade finance before the Final Meeting. Unfortunately, that has not happened. However, we know very well that each of the parties concerned did their best to try to materialize the deals. Firstly, the IIMA appreciates very much for the cooperation extended by the three Japanese banks in Vietnam with respect to yen stand-by facilities for the VCB for the pilot transactions to come. The IIMA is aware that the three Japanese banks have been eagerly waiting for the VCB to come with actual transactions. Secondly, the IIMA also appreciates that the VCB has been doing its best for the project. The VCB has organized a bank-wide project team and has conducted comprehensive studies on the new products as well as internal workflows, and now has started marketing the products to the bank’s potential customers. The IIMA is aware that VCB has strong commitment to doing its best towards the implementation of the pilot transactions, and intends to reach basic agreement promptly. Thirdly, the IIMA also appreciates that the SBV has made every effort in providing guidance to the parties concerned and encourage them to overcome the challenges. As we emphasized in our earlier presentation, it is important for the Vietnamese monetary authorities, financial communities and businesses, to get prepared for changing financial and economic environment. It is in this perspective that pilot transaction of trade finance in yen will have a significant meaning as part of the efforts for such preparation by all the Vietnamese parties concerned. Although the current project expires toward the end of March, it should be noted that the Japanese authorities concerned will continue to closely follow up what will happen with the ongoing pilot cases. Should the pilot transactions go well, the IIMA believes it will definitely have a positive implications for considering programs for next year. The IIMA therefore would like the SBV and the VCB to fully inform the IIMA of the progress of the ongoing negotiations of the pilot transactions.”

6. Bilateral meeting between the SBV and the IIMA after the Final Meeting

As the pilot transactions did not materialize on or before the Final Meeting, the IIMA and the SBV had a bilateral meeting on the following day to discuss how the pilot transactions should be followed up after the FY2005 research project would expire toward the end of March 2006. The IIMA requested the SBV to follow up the subsequent negotiation process between the VCB and its potential customers on the transactions and to inform the IIMA of the status of the progress, which the SBV accepted. The two parties also discussed public relations issues which they would have to consider if and when the pilot transaction materialized.

7. Workshop on yen trade finance by the VCB for its customers

As part of the FY2006 project, the IIMA sponsored a workshop on yen trade finance that was held by the VCB for its customers in the week of the Final Meeting. The workshop was attended by 12 VCB’s clients. The VCB made presentation on its proposed yen trade finance scheme, giving detailed numerical explanations on each of the financing cost of the three financing cases, namely US dollar denominated finance, Vietnamese dong denominated finance, and Japanese yen denominated finance, together with hedging costs that should be required for protecting against

relevant currency fluctuation, for assumed export and import transactions, and emphasized the attractiveness of yen trade finance. The VCB also gave explanation to its customers about foreign exchange hedging instruments such as forward contracts and options in accordance with case examples. The VCB indicated its customers at the meeting responded positively to VCB's yen trade finance schemes.

8. Achievements

Following the preparatory process for the period from September to November 2005, the project officially started at with the Launching Meeting on December 9, 2005. The project went into full swing with the formation of the Working Group by the SBV and the IIMA toward the end of December. The activities of the Working Group moved to a second phase with the VCB's joining the Working Group in early January 2006. In order to pursue materialization of yen trade finance with Vietnamese enterprises, the VCB started bilateral talks with Japanese banks in Vietnam in respect of yen funding related issues while it made bank-wide efforts to develop new product (i.e. yen trade finance) and workflows. The VCB also prepared for commencing bilateral negotiations with potential customers. The SBV and the IIMA actively provided indirect support for the project.

While the scope of the research project of the FY2004 had been contained to discussing the feasibility of yen denominated trade finance, the FY2005 project made a big step forward toward materializing pilot transactions of yen trade finance, including formation of the supporting framework. The achievements under the FY2005 project could be summarized as follows:

- (i) It was confirmed that each of the three Japanese banks in Vietnam was ready to provide the VCB with cooperation in connection with the necessary yen funding for the VCB for its pilot yen trade transactions with its customers.
- (ii) The project helped the Vietnamese participating bank gradually recognize that yen trade finance would provide a good opportunity for the bank to improve its institutional capacity for diversified financial products and risk management.
- (iii) The VCB made marketing efforts to materialize yen trade finance with potential clients. These efforts included organizing a workshop to enlighten its clients by giving detailed numerical explanations on each of the financing cost of the three financing cases, namely US dollar denominated finance, Vietnamese dong denominated finance, and Japanese yen denominated finance, together with hedging costs of the derivatives to be used (e.g. forward contracts and options), for assumed export and import transactions.
- (iv) Although the pilot transactions have not been materialized before the expiry of the current project, the VCB is still continuing its efforts to reach basic agreement with its potential clients. The SBV is also continuing to provide its support to the VCB.

9. Conclusion

If we put the FY2005 project in retrospect, we were initially concerned about what we had felt in the level of enthusiasm of the Vietnamese side toward materializing pilot transactions. However, we were convinced that such concern disappeared completely at later stage.

We would like to point out that the development of the sense of strong ownership of the project on the part of Vietnam has made the Vietnamese side more committed to the project. Indeed, fostering the sense of ownership by Vietnam has been the very point to which the IIMA, as the commissioned

promoter, has taken the utmost pain in the process of promoting the project. From the perspective of the importance of building sense of ownership on the part of the recipient country of technical assistance, we would like to note particularly the following points.

(1) The project has been promoted by the IIMA as part of the bilateral technical assistance budgeted by the Japanese government, taking fully account of Vietnam's needs and requests. In addition, the project has been fully participated by the Vietnamese side. It is of note that this project has been jointly promoted right up until the last stage of the program, which we believe would make this technical assistance project unique and substantially different from those technical assistances traditionally provided by the multinational agencies, or by Europe or the United States.

Technical assistances are typically conducted by international consultants who would prepare prescriptions for the recipient countries in accordance with the commissioned projects, without active participations by the countries in the relevant projects. Once such prescriptions by the consultants are completed, they tend to be left ignored without any follow-up actions by the recipient countries.

Under the FY2005 research project, the IIMA, being commissioned by the Ministry of Finance of Japan, through close consultation and co-work with the SBV (the Vietnam's counterparty of the project), focused to identify the needs of Vietnam's side in drawing up the details of the project. The major points so identified through the process of the close co-work between the IIMA and the SBV are described below together with the subsequent developments in each area.

(i) The SBV had keenly realized the lack of experiences and skills of Vietnamese businesses with respect to foreign exchange risk management and felt the need for capacity building in banking and corporate sectors in this regard. As described in the preceding section, the IIMA and the SBV organized, as part of the current project, a seminar on foreign exchange derivatives.

(ii) It was initially assumed that the project would conduct simulations for hypothetical export and import transactions using market-based rates that would be applicable to real transactions. However, it was subsequently recognized strongly by the Vietnamese side that ensuing materialization of real transactions for pilot case would be more conducive to capacity building. Such recognition apparently motivated the SBV to provide its strong support to the whole process of the project and tenuous encouragement to the VCB.

(iii) The IIMA, on the other hand, emphasized the merits of providing yen trade finance for the VCB, by appealing it would diversify the financial products by the VCB and lead to the enhancement of bank-wide institutional capacity in foreign exchange risk management, and strongly encouraged the VCB to pursue such merits through materializing pilot transactions. We believe that the sense of the ownership of the project by the VCB was fostered with increasing recognition by the VCB of such merits.

(2) What we became painfully aware of through conducting the FY2005 research project was the fact that Vietnamese businesses (both banks and companies) have been, and still are, extremely cautious about the high volatility of the Japanese yen, as they saw at one stage back in late 1990s the Japanese yen hit its strongest against the US dollar below 80. This cautiousness is the major cause for the reluctance of the use of the Japanese yen by the Vietnamese businesses. As was commented by the SBV during the Q&A session, the Vietnamese businesses' memories about the high volatility

of the Japanese yen, which had caused huge losses on their import transactions in the past, have been so vivid that they are still reluctant in using the Japanese yen. However, as was also stated by the SBV, the business operating environment has changed and improved substantially in recent years, with new developments in regulatory framework of foreign exchange transactions including risk hedging instruments (e.g. derivatives) and enhanced capacity of commercial banks in this regard. We would like to note that the SBV commented to the effect that Vietnamese enterprises' psychological resistance to use of the Japanese yen would be eventually overcome if and when the Vietnamese enterprises would be offered evidently by the Vietnamese banks with the detailed yen financing terms which would be effective in terms of all-in cost compared with other financing methods and that it therefore hoped the VCB would successfully complete the pilot transactions. Please refer to section 5 (3) for Q&A session.

In the process of promoting the FY2005 research project, the IIMA focused to draw SBV's attention to the following points so that the project would have implications for potential important needs for Vietnam in the future from a longer range perspective.

(i) With expected further developments of coordination in foreign exchange rate policies among the countries in the Asian region, the currencies in the region are likely to move in a relatively stable range vis-à-vis the other regional currencies whereas they are likely to fluctuate freely vis-à-vis non-regional currencies (e.g. the US dollar and the euro).

(ii) It is important that the SBV, as the monetary authority, and Vietnamese banks and enterprises should get prepared for the expected economic and financial developments in the Asian region as envisaged in the above.

(iii) Adding the Japanese yen to Vietnam's transaction currencies along with the Vietnamese dong and the US dollar should be a useful and necessary step for the country's economy. Promoting the use of yen in trade finance in Vietnam should have significant meaning from this perspective.

We believe the SBV's awareness of the needs in the future from a longer range perspective as discussed above should have enhanced the sense of the ownership of the project by the SBV.

(3) The SBV, as a member of the Working Group, exercised its leadership on the part of Vietnam in encouraging the ministries concerned, commercial banks and enterprises to participate in the public discussion process. The public discussion process proved to be very successful in that it provided the participants with excellent opportunities for exchanging views and building capacities by educating each other. In addition, the public discussion process clearly created the sense of the ownership of the project among the Vietnamese participants as a whole.

The pilot transactions of yen trade finance have yet to materialize at the time of this writing. Should the transactions materialize, it will definitely have an epoch-making significance. It should also be pointed out that a strong sense of the ownership of the project by the Vietnamese side, both public and private, has been clearly fostered in the process of pursuing the pilot transactions, which we believe will have a very positive bearing on the eventual materialization of the transactions. We also believe that a leading role played by the Japanese side to foster the sense of ownership by Vietnam would offer a valuable insight for the way in which technical assistance is to be implemented.