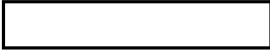


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DIRECTORATE OF
INTELLIGENCE

Intelligence Report

The Economic Situation in South Vietnam (Biweekly)

State Dept. review completed

USAID review completed

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence

The Economic Situation in South Vietnam

Summary

A greatly modified "program law" probably will be approved by the National Assembly shortly, but it is not clear what latitude it will give President Thieu to enact economic reforms. The National Bank of Vietnam already has effected an interest rate reform designed to counter inflation.

The Australian Government is planning substantially increased aid to South Vietnam during the next three years, and the Japanese Government has decided to increase assistance now rather than waiting until hostilities cease.

Retail prices in Saigon increased three percent during the first two weeks in September to a level about 30 percent above the average level for December 1969. Black market prices for dollars and gold remained high, while the rate for scrip declined.

ANNEX: Monthly and Weekly Currency and Gold Prices
(Graph)

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Economic Reforms -- Interest Rates

1. After months of delay a greatly restricted version of the so-called program law--President Thieu's request for decree powers over economic matters--probably will be approved by the National Assembly within the next week or two. At a minimum, the law will provide for an exchange rate substantially above the present official rate of 118 piasters to the dollar to apply to purchases of piasters by American personnel in Vietnam, a measure of little benefit to the Vietnamese. The higher rate also may apply to certain classes of imported luxury goods, which would tend to discourage purchases of such goods and reduce importers' profits. It is not known which of the other economic reforms the government originally had planned to carry out under the program law can or will now be enacted by President Thieu on his own authority. The passage of even a very limited program law, however, could improve Thieu's political position sufficiently to permit him to go ahead with unpopular measures. With Thieu's approval, the National Bank of Vietnam (NBVN) already has put in effect a new interest rate program, the major objective of which is to reduce the rate of inflation.

2. The National Bank has raised its rediscount rates (the rates at which commercial banks borrow from the NBVN) and informed each of the commercial banks that it is to set its own interest rates for loans and deposits and submit them to the NBVN for approval. The new rediscount rates, effective 14 September, are 10 percent for export paper and 18 percent for all other commercial paper. A penalty rate of 24 percent was established for commercial banks whose loans exceed the maximum level set by the NBVN. Rediscount rates formerly ranged from four percent to a penalty rate of 12 percent.

3. The Saigon bankers' association, which has effectively set interest rates in the past, reportedly would have preferred to avoid any competition by submitting one set of rates for all banks. The government-owned Credit Commercial, however, which is the largest commercial bank in Vietnam, has set

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its own minimum and maximum rates for loans and all other banks are falling into line, apparently without any serious opposition. The new loan rates range from 14 percent (for exports) to 24 percent per year compared with former rates of eight percent to 14 percent. Individual banks, however, will be able to compete with each other for loans at rates between these limits based on the credit standing of the borrower.

4. Credit Commercial has raised the rate for regular savings accounts from five percent to eight percent per year. Rates for time deposits will range from 10 percent per year for one-month deposits to 20 percent per year for 12-month deposits. A 12-month time deposit has been earning 12 percent per year since March 1970 when the rate was raised from four percent. Other commercial banks reportedly are setting similar rates, but the NBVN is encouraging banks to negotiate freely with individuals to set rates and maturities for large deposits.

5. The Agricultural Development Bank, Vietnam Development Bank, and the Industrial Development Center have not yet increased their interest rates. Rates on agricultural loans are expected to be increased soon, but interest rates on loans for industrial development probably will remain low in order to encourage local investment.

6. Two objectives of interest rate reform in South Vietnam are to increase savings so as to reduce inflation and ultimately help finance economic development and to promote confidence in financial institutions and the government. Institutional interest rates have been much below the rate of inflation, so that holders of savings and debt instruments lose money, while debtors receive a bonus. In this situation credit has to be rationed, frequently on the basis of influence. Savings are penalized, spending stimulated, and speculation encouraged, especially by importers who are the major recipients of commercial bank credit. Speculation, in turn, has drained foreign exchange reserves and further reduced confidence in the piaster.

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7. Although an increase in interest rates is a step in the right direction, the new rates fall well short of the rate of inflation, and, therefore, will not eliminate, nor necessarily alleviate, these problems. To be effective, interest rate reform will require further, probably substantial, increases in rates. Interest rates consistent with current market conditions probably would exceed 40 percent annually, at least approximating the rate currently obtained in the private money market. An effective interest rate reform would be an important anti-inflationary move, but by itself cannot contain inflation in South Vietnam.

Increased Assistance from Australia and Japan

8. The Australian Ministry of External Affairs has proposed a substantial increase in economic and military aid to South Vietnam during the next three years. The Japanese Government also plans to increase assistance to South Vietnam, but apparently prefers to extend loans rather than grants.

9. Preliminary Australian plans call for combined military and economic aid to rise from \$3.2 million in FY 70 to \$8 million in FY 72. The total aid level would decline slightly in FY 73 as military aid is reduced, but economic aid is scheduled to reach a new high of \$5 million that year compared with \$2 million in FY 70. Much of the increased military aid will be used to provide foodstuffs and other commodities for the Vietnamese Army and to construct housing for military dependents. Specific uses for the additional economic aid are not known, but in the past Australia has sent medical and civil engineering teams to Vietnam and provided commodities such as construction materials, textbooks, and radio equipment. Although Australian economic assistance to South Vietnam is less than one half of one percent of US economic aid, the proposed program represents a major increase in Australia's commitment to South Vietnam, especially following the recently announced expansion of aid to Cambodia.

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10. Tokyo currently provides South Vietnam about \$1 million per year mainly in the form of scholarships and medical personnel and equipment. In connection with Prime Minister Khiem's visit to Japan last month, the Japanese Government announced that it will provide a \$4.5 million loan for the construction of an electric power station in Saigon. The loan offer is one of the first indications that the Japanese are willing to increase assistance now rather than waiting until hostilities cease. The Japanese also are sending a team of technicians to Vietnam early in October to survey other projects which Japan might agree to finance. Negotiations on the terms of the power station loan are under way, but no settlement has been reached.

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US and Vietnamese officials, on the other hand, naturally would prefer a grant rather than a loan, even on the most favorable terms. Japanese embassy spokesmen in Saigon have indicated to US officials that if loan terms acceptable to both governments can be arranged on this first Japanese offer without too much delay, further assistance, some in the form of grants, would be forthcoming. The Japanese already are committed to spend about \$3 million repairing the Da Nhim hydroelectric power project near Da Lat. Construction was financed from Japanese reparations, but the plant has been out of operation since 1965 because of enemy sabotage. Repairs will not begin, however, until the South Vietnamese can provide adequate security for Japanese technicians.

Prices

11. Retail prices in Saigon increased three percent during the first two weeks in September. As measured by the USAID weekly index, prices on 14 September were about four percent above the average price level for August and about 30 percent above the average for December 1969.

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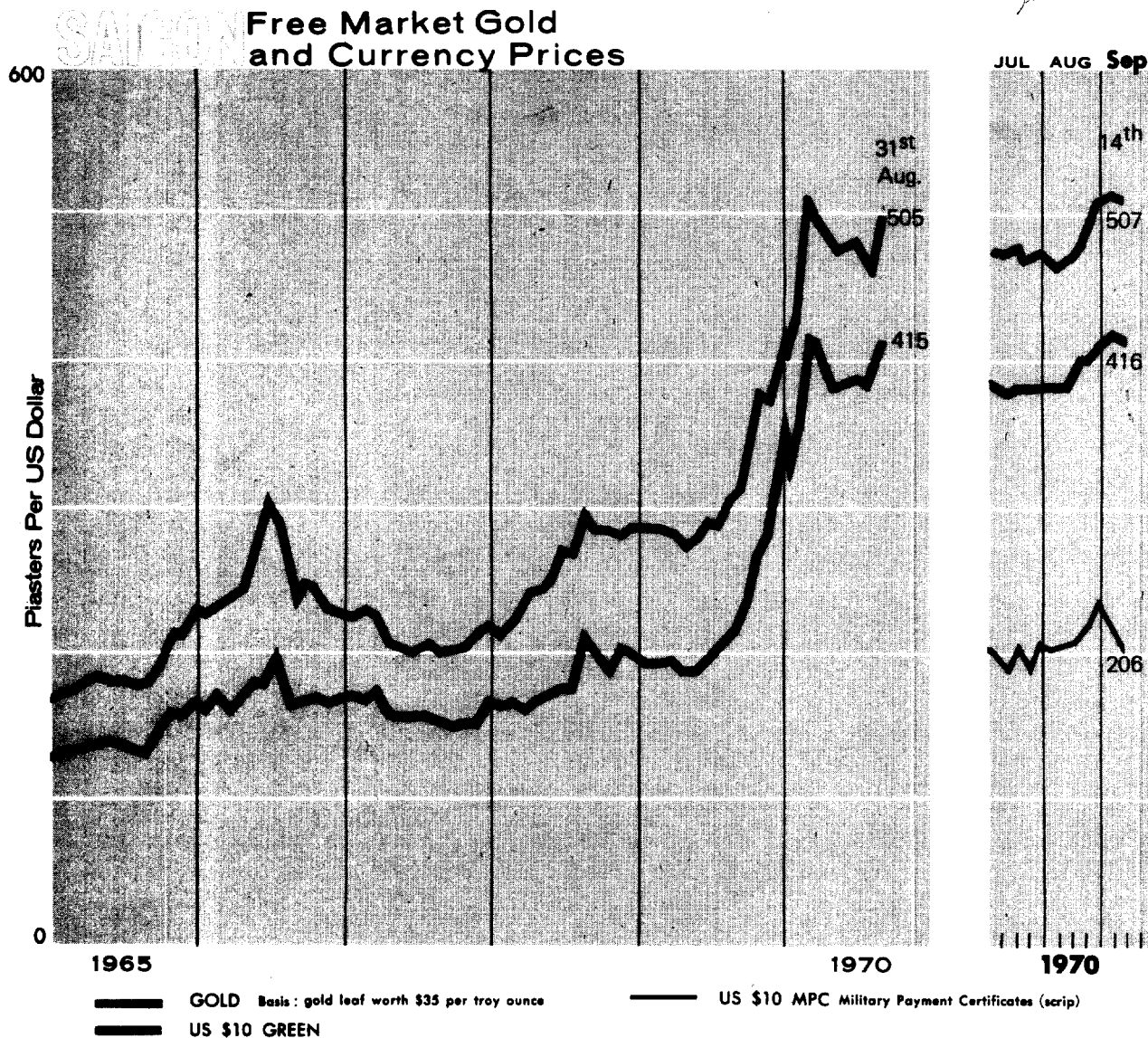
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Currency and Gold

12. With many buyers in the market, Saigon black market prices of dollars and gold remained at a high level during the first two weeks in September. On 14 September the price of dollars was 416 piasters per dollar and the prices of a dollar's worth of gold leaf was 507 piasters. The rate for MPC (scrip) declined during the period from an all-time high of 240 piasters per dollar to 206 piasters per dollar, probably because of rumors that a new series of MPCs will be introduced when the exchange rate for American personnel is changed (see paragraph 1). (A graph on monthly and weekly currency and gold prices is included in the Annex.)

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