CHAPTER 1
INTRODUCTION

1.1 The statement of problems

As traditional definition, bubble is a phenomenon that is "*trade in high volumes that are considerably at variance with intrinsic value*[1]", and there existed some bubbles around the world in the past, according to Abreu and Brunnermeier (2003), there are some bubbles in the past such as the Dutch Tulip mania of 1630's in Netherlands, the South Sea bubble of 1719-1720 in England and the Internet bubble in the early 2000; and Edison, Luangaram et al. (1998) illustrated the financial crash in East Asian by employed the model of Kiyotaki and Moore (1997) for Thailand, Korea and Indonesia was a result of asset bubble in financial crisis in 1997 which was started from Thailand. There were some scholars such as Hardouvelis (1988), Dwyer and Hafer (1989) tried to detect the existence of bubbles in stock markets of England, United Stated, and Japan in the middle of 1980's or Brooks and Katsaris (2003) found that the bubbles existed in London Stock Exchange from 1993 to the end of 1990's. The evidence of bubbles have not only detected in stock markets, it also presented in other markets i.e. foreign exchange market or the real estate market. The bubbles exist due to investors' behavior of speculation into the market and make the market prices to excess with their fundamental values to gain as much profit as possible.

From the international evidence of bubbles in financial market, if the bubbles exist, they will be burst in the future, those two phenomena illustrate that the market is inefficiency, and a burst or collapse of the market is not only seriously to the market itself but also the whole economy could receive more problems from the burst; it could make slowdown of economic growth and resources of the economy are misallocated: Although the bubbles make more liquidity for assets, but the unbalance between demand –supply in short term will make a fever to the market, then the real demand and prices in the market are increased, investors feel that they are wealthier

[1] Fundamental value

and could consume more; but if a burst is next to that , the consumers will cut off their consumption since they lose their wealth, it could lead to a collapse for the market caused by a deeper falling in the prices: it easy see in the bubbles and burst in stock market from 1929 in the United State was a reason of “Great Depression” during 1930’s or the boom of Japanese economy in 1987 and then the recession made the whole economy being weakness or the expansion of financial crisis in Asia to many countries in 1997 was a serious situation of the sustainable development for a country.

Last three years, the Vietnam stock market had a sharp boom and then declined quickly in stock price, the change was forth fold. Investors in the market were scare of a burst from the stock price bubbles, and if it was real, the effect to whole economy is serious as other countries in financial crisis in the year of 1997. Whether the bubbles exist in the Vietnam stock market is the most concern for both investors and policy makers.

For eight years of establishment, there have been 157 listed companies in Hochiminh stock exchange (HOSE) in December 2008, except bonds and investment certificates (4 investment certificates), the VN-Index2 has an amazing fluctuation from 2006 to April 2009, it was about 300 points and reached a peak in March 2007 (over 1,100 points), then after that it fell around 250-300 points at beginning of 2009:

+ The soar was caused by increasing day to day of new investors during 2006-2007;

+ And then the decrease was a consequence of moving capital from stock market to the real estate market and withdrawn of investors who were afraid of existence an overvalue of stock market.

In the period of 2006-2007, almost of listed items had increased at least 100% and stock market was a chance for who wants to get high return in the short

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[2] VNindex is a value weighted index for Vietnam stock market. It is calculated with all of the market value of listed securities in the stock exchange. Its formula (Paascher index):

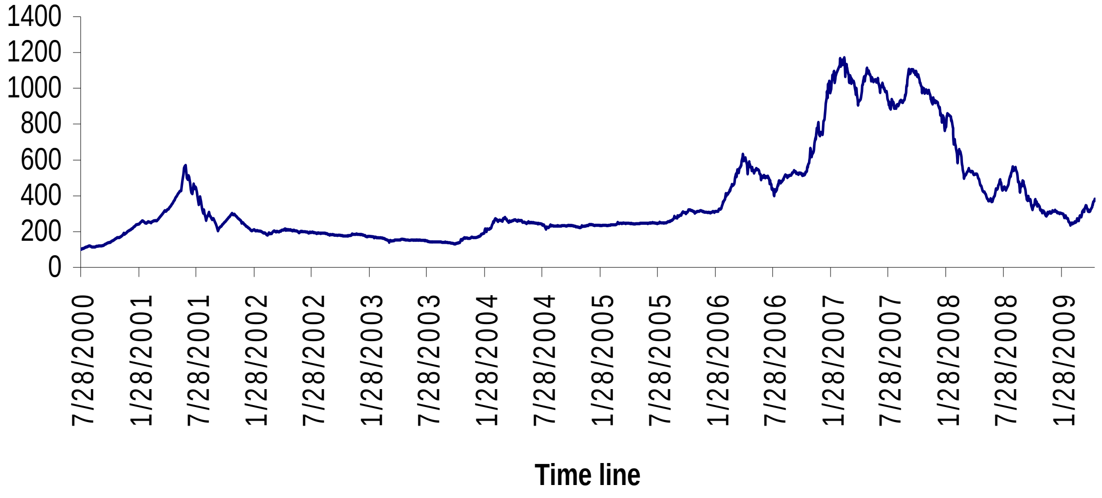
$VNindex = 100\sum_{i=1}^{n} P_{ti}Q_{ti} / (\sum_{i=1}^{n} P_{0i}Q_{0i})$; in which t is the time, Pi and Qi are trading price and quantity of stock i at time t, respectively. The initial VNdirect was 100 at the first day of stock exchange.

time. The dramatic change of stock prices in two years was made the most concern of investors and authorities, also for the financial institutes about the real value of each listed share in the market. It showed that all of listed items had an increase dramatically in comparison to their first listed day, and that was a consequence of exceeding the buying orders in the stock market: it seemed that investors did not want to know the real valuation of the share and its business strategies, holding and selling after some days was a high return. Schainkman et al (2003) stated that behavior of participants in the stock market was "overconfidence" and they knew the bubble, but they would like to get advance from the bubble, namely "speculative bubble".

The explainable reason for this phenomenon is argued by many scholars and institutes: there was a slowdown in the real estate market after a boom in 2002; and an increase of IPOs before 2006; moreover, there were some indirect impact from the attractive FDI in 2006, the increase of credit growth in previous years also was a reason for that change in the stock market.

Figure 1.1

VNindex from 2000 to 2009



Source: Hochiminh Stock Exchange (www.hsx.vn)

As the period of fever of the stock market, many institutes and foreign economists warned that there could be a bubble for the stock market and all of prices were over their fundamentals and the high risk for a crash could be happened. But others argued that the booming of prices could be a result of an attractive foreign direct investment (FDI, about 25 billions dollar), and many of that source was poured into the financial market via the hedge fund or investment fund; or some assessed that the valuation of IPOs (initial public offers) was under the real value, and as same as the Russian program during the beginning of 1990s[3], after the share was listed investors recognized that the real value of that share was higher the market price and it made a fever for them to hold it. Those arguments have not strong evidences to explain investors' behavior and the phenomenon of soaring stock prices, but they provided for investors and the market some directions to decide their action.

Facing to those problems, the State Bank of Vietnam (SBV) must involve issuing some policies to avoid any risk from the stock with bad credit or outstanding debt at the beginning of 2008[4]. Moreover, the SBV required the commercial banks to have higher reserve[5] to control the broad money supply and to reduce the risk from outstanding debts from the stock market and the real estate market. The decision of SBV was forced the securities companies and banks to have a tightening policy for any loan in the stock market then it was a bad news for the market , that was a reason for investors sold their stock as soon as possible to refund their loan and the stock was changed direction of prices. Many investors were affected from their loan for stock trading and they have to refresh their portfolio in the better way (holding blue chip[6] and selling penny). The market had a change to other side; and the blue chip stocks were not much in the market, which suddenly make the opposite trend to the past, selling of stock.

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[3] From 1990, Russia designed a privatization program which was privatized almost state owner companies, and they assessed the low valuation for these companies, that lead to a rush for Russian to hold the shares.

[4] The decision No.03 of SBV: it required the Securities and commercial banks that they are not allowed to have the debt over 20% of their registered capital and the outstanding debt for stock loan is not over 3% of total.

[5] The decision no.187/2008/QD-NHNN (16th Jan 2008) increased the reserve for commercial banks 1% for each kind of saving account.

[6] Blue chip stock is a stock of a well-established company having stable earning and no extensive liability (Wikipedia: http://en.wikipedia.org/wiki/Blue_chip_(stock_market)). It is opposite with penny stock: cheap and small companies (in Vietnam)

1.2 Objectives of the study

Regarding to the above problem, the objectives of the study are:

1. To detect whether the rational speculative bubble existed in the Vietnam stock market during the period of 2003:1-2009:4 that was the main concern from the State Bank of Vietnam and government agencies.

2. To examine the impact of monetary policy via some instrument policies of the State Bank of Vietnam on stock returns with the approach of managing the fever of the stock market; and the response of stock returns to the monetary policy in both cases of increasing and declining stock prices, in which a prediction of movement of stock returns will be calculated based on other conditions of monetary policy variables.

1.3 Scope of the study

The study focuses on the existence of bubble in the Vietnam stock market and would like to find out the sources of booming stock prices during 2006-2008, although the stock exchange was established in 2000, but to avoid of another boom in 2001-2002; the study will use the data from 2003:01-2009:04 for testing. In addition, there are some arguments about irrational investors in the stock exchange, but the study will not include their behaviors as a source of bubble since there are some problems to measure noise trading; it is also explained in various articles that bubbles occur due to "animal spirit" or irrational investors, this source of bubbles is discussed in theory to give more understand the situation of the Vietnam stock market.

The impact of stock returns and monetary policy could have been two sides; one effect is shown by the investors' responses to the policies of SBV, since SBV would like to control the financial sources in the stock market (to both domestic investors via the interest rate and foreign investors via the exchange rate). The other impact is responses of SBV to the change of stock prices, since the stock prices boom, SBV would like to employ its tools to cool down investors' fever.