REBOUNDING MARKET INTEREST RATES IN FEBRUARY

Unexpected Rise in Corporate Yields

The benchmark three-year corporate yield, which showed a stable downward trend in January, has risen again since February, although the yields on other bonds have been a bit more stable. The yield on corporate bonds dropped by 0.42% in January, but rose again by 0.38% during the first 27 days in February.

There are several reasons to explain the trend of rising rates. First, the bankruptcy of Hanbo Steel Ltd., Korea's largest corporate collapse since the breakup of the Kukje Group in 1980, on January 24, caused the Korean capital market to become unstable. The Hanbo bankruptcy led to the collapse of small and medium-sized companies that were connected in business with Hanbo because of their unredeemable bills from Hanbo. This difficult financial situation combined with the overall economic downturn further aggravated the conditions of small and medium-sized companies such that the monetary authorities pursued a flexible monetary management; however, this influenced market investors to worry about price levels and to buy the bonds passively.

Besides these reasons the monetary authorities' intervention in the foreign exchange market in the middle of February also affected the stability of the financial market. Because of the Korean won's fast depreciation against the dollar, monetary authorities sold dollars in the market so that the liquidity shrank and the interest rates increased.[1]

There is a more fundamental reason for the rise in the yields—the over-supply of bonds. Firms' lack of working capital have caused them to issue more corporate bonds. Furthermore, because the sluggish stock market cannot help firms raise capital, the bond market has suffered from disequilibrium as of late.

"Firms' lack of working capital due to the plummeting national economy and exports have caused them to issue more corporate bonds."

Low Expectation of Sharp Decreases in Rates in March

Although the reasons for the increases in rates are not likely to improve much in March, the rates will fluctuate around the low 12 percent range due to the following: first, the effects of the over-supply of corporate bonds are already reflected in the market. Second, most firms plan to invest in facilities less rigorously so that their demand for capital will not increase much until an upward indication of business appears. In addition, the government's strong intention of lowering the interest rates may cause market investors to assume a downward (or at least stable) trend in rates.

However, the over-burden of foreign debt due to the depreciation of the Korean won against the dollar may lead the monetary authorities to intervene in the foreign exchange market and cause the market liquidity to shrink. Overall, in order to keep the rates stable (or lower them) at present, achieving stable price levels would be the most important factor since many are worrying about inflation due to the recent flexible money supply policy. VIP

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1) Fortunately, the government's recent intervention caused the market interest rates to increase sporadically, not continuously, and thus, this effect will diminish soon.