

FINANCIAL INSTABILITY NOT ON THE WANE

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Lingering Worries

Ever since the Kia Group fell under its creditor banks' antibankruptcy pact in July, the money market has been suffering from increases in the amounts of financial institutions' insolvent loans and a decrease in market liquidity. Merchant banks in particular have been suffering from more severe liquidity shortages than commercial banks. This shortage of market liquidity has further made firms' turnover of capital difficult. The instability of the money market due to this liquidity shortage of financial institutions and firms naturally raised the market interest rates and yields on bonds. The rate of dishonored bills also rose during July, which implied that firms were having a difficult time to raise operating funds and the money market was not stable.

For example, the yield on three-year corporate bonds rose by 0.32 percentage points and 0.28 percentage points during July and August, respectively. The yields on other kinds of bonds such as bank debenture and national housing also increased in August.

In order to calm the financial market instability, the government approved the central

bank's emergency loan, at a rate of 8.5 percent, to the Korea First Bank and any merchant banks which submitted self-rescue measures to the monetary authority on August 25th. This special loan program was intended to raise the recipient's overseas credit standing and to ease liquidity crunch, but it did not help the financial market such that the stock and foreign exchange markets did not show positive signs.

Still Worrying about a Financial Crisis

There are still some rumors of other business groups' financial problems and difficulties in raising capital for financial institutions. In addition, there is special seasonal high demand for money at Chusok, the Korean Thanksgiving holiday, in the middle of September. Furthermore, the Korean won's recent rapid depreciation against the dollar is also weakening the stability of the money market, which may continue for the time being. Thus, the market interest rate and yields on other kinds of bonds are likely to stay around the present rate. The importance of monetary policy will become more crucial during the current financial instability in terms of easing the money market. **VIP**

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<Table 1> The Rate of Dishonored Bills and Major Bond Yields (%)

	Dishonored Bills		Corporate ¹	Bank Debenture ²	National Housing ³
April	0.25	June 1	11.88	12.58	11.20
May	0.23	July 1	11.63	12.25	11.10
June	0.22	Aug. 1	11.95	12.25	11.25
July	0.24	Aug. 27	12.23	12.50	11.35

Note: 1) 3-year maturity, 2) 1-year maturity, 3) 5-year maturity