

ARE DECLINING INTEREST RATES ENTIRELY GOOD NEWS?

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Lately, one of the brightest economic indicators in Korea has been the significantly declining interest rates. Recent data reveals that major money market interest rates are falling to pre-IMF levels. As the Korean economic crisis approached its peak in the middle of last December, most interest rates skyrocketed to above 30 percent per annum. Therefore, the current interest rates of around 12% may be a good gift for the "money hungry" firms.

The declining trend in interest rates can be explained by several factors. First, even though the Bank of Korea is keeping its contractionary stance on the monetary policy, the strength of the stance has gotten quite weaker because of the need to provide liquidity to distressed financial institutions. This flexible monetary policy is partly possible due to the declining exchange rate. Second, purchases of highly-rated corporate bonds by healthy financial institutions has increased recently, since their deposits have crowded by cash flows weaker financial institutions. Third, the changes in the deposit insurance policy has led healthy financial institutions to lower their lending rates as

well as savings rates. Nobody can assure that interest rates will fall into 10 percentage range in the near future. However, interest rates are expected to be around current levels, since the recent memorandum on the economic program between the Korean Government and the IMF allows a monetary program with adequate scope for accommodating a further gradual reduction in interest rates without sacrificing the inflation target.

However, as long as a few problems remain in the markets, the reduction in interest rates will only benefit some large firms. First of all, financial institutions' lending rate should be reduced further and the risk premium in their lending for small firms should be appropriately adjusted as well. Second, resolving the credit crunch is a more important task than reducing interest rates. As the financial restructuring continues under way, most firms have had difficulties in obtaining funding even though they are willing to pay higher interest and financial institutions have sufficient money for lending. Until these problems are resolved, the current decline in the money market interest rates may only be a mirage to most firms. **VIP**

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<Table> Major Interest Rates

(End of Period, %)

	1997	1998			
		May	June	July	Aug.12
Corporate Bond Yield(3 yr.)	28.98	17.82	16.00	12.30	12.25
CD Rate(91 days)	25.00	17.70	16.30	12.06	11.00
Call Rate(1 day)	26.49	18.25	14.42	10.24	9.53