UNCERTAINTY REMAINS FOR INTEREST RATES

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"If the turmoil in international financial markets continues, the present stability in the foreign exchange market cannot be guaranteed, resulting in a rise in market interest rates."

Recently, the interbank overnight call rate declined to below 9%. This shows that financial institutions are still managing their funds in relatively safe short-term assets against possible turmoil in the financial market while financial reform is being accelerated.

On the other hand, the three-year corporate bond rate has not shown any serious downward movement since the end of July. Instead, it has fluctuated within the 11%~13% range through August. There are a few reasons why it has not continued to fall, even though financial institutions have enough liquidity to provide. First, financial institutions are hesitating to purchase bonds issued by firms with lower credit ratings, since the payment of corporate bonds, which used to be guaranteed by the two guarantee insurance companies until the end of August, are not backed up by the government's deposit insurance policy. Second, institutional investors, such as investment trust companies, are tending to reduce their purchasing of bonds in order to prepare for possible emergency fund withdrawals. Third, the supply of corporate bonds is increasing because many firms expect interest rates to rise due to the tremendous amounts of government bonds scheduled to be issued late this year. Finally, the partial moratorium announcement by the Russian government has had a negative effect on money market interest rates through its impact on international financial markets.

Both positive and negative factors will simultaneously affect the movement of money market interest rates in the near future. As a positive factor, domestic monetary policy will put downward pressure on interest rates. As the economic recession deepens more than expected, the government has announced its intention of easing its monetary policy in order to mitigate the liquidity shortage.

However, negative factors still remain while putting upward pressure on interest rates. One of those factors is the effects of the instability in international financial markets on the foreign exchange market in Korea. If the turmoil in international financial markets continues, the present stability in the foreign exchange market cannot be guaranteed, resulting in a rise in market interest rates. The decreasing pressure on demand for corporate bonds because of the huge amounts of government bond issuances and also the restructuring processes among financial institutions, will also have a negative impact on interest rates. VIP

〈Table〉 Major Interest Rates

(End of Period, %)

	1997	1998			
		May	June	July	August 28
Corporate Bond Yield(3 yr.)	28.98	17.82	16.00	12.50	11.90
CD Rate(91 days)	25.00	17.70	16.30	12.29	10.32
Call Rate(1 day)	26.49	18.25	14.42	11.10	8.70