

TEST OF STABILITY OF LOW INTEREST RATES

by Tae-Yol Lee
(e-mail: tylee@hri.co.kr)

"In spite of the possibility of negative shocks from outside Korea or in the process of domestic restructuring, interest rates and bonds market will remain stable and thus provide a favorable environment to boost the economy, for the time being."

From mid-January, market interest rate, or the 3-year corporate bond yield, began to show an upward trend. In February, the rate went over 8.5% mark, a rise of more than 1.5%p compared to the lowest point of a month ago. Fortunately, it has not yet exceeded 9%. This means that the base of low interest rate is still being sustained. In fact, since the interest rates entered to the 7% zone, there have been 3 major trials to test the stability of this record-low interest rate. The first one was financial crisis of Brazil, which cooled down the optimism in the market about an early economic recovery. As a result of this, the market rate went back to over 8.0% in two weeks. The second test was the restriction on short-term fund management of investment trust companies. In January, a tremendous amount of money, about 24 trillion won, in the financial market moved into short-term funds of investment trust companies, which re-invested these funds in long-term bonds for higher returns. This action, however, could lead to a 'maturity mismatch.' Worried about future financial instability stemming from this mismatch problem, the government came to place restrictions on the short-term funds' investment management methods. As a result, the demand for 3-year corporate bonds sharply decreased in mid-February. The third is

the devaluation of yen from 116 yen per dollar as of January to over 120 yen in mid-February. The weaker yen means weaker price competitiveness of Korean products in the world market. In order to protect the price competitiveness, the BOK seems to have indirectly intervened in the market. Consequently, the won began to follow yen's movement. But the central bank's determination to keep low interest rates, domestic market rates did not react significantly.

The Bank of Korea has continuously lowered its RP rate, which is its major interest rate steering tool. The call money rate, which is perceived as a substitute of the RP rate, moved down as well. Both rates reached around 5% at the end of February. These historically low rates surely kept other market interest rates from soaring upward. Since mid-February, the 3-year corporate bond rate has shown a stable movement in the range of 8.5-9.0% while the 3-year government bond rate has stayed around 7.0%. In spite of the possibility of negative shocks from outside Korea or in the process of domestic restructuring, interest rates and bonds market will remain stable and thus provide a favorable environment to boost the economy, for the time being. **VIP**

<Table> Major Interest Rates

	1997	1998	Jan.	(End of Period, %)	
				1999 Feb.	March 4
Corporate Bond Yield(3 yr.)	28.98	8.00	8.13	8.65	8.58
CD Rate(91 days)	25.00	7.70	6.77	6.61	6.55
Call Rate(1 day)	26.59	6.53	6.15	5.14	5.06