UNSTABLE FACTORS STILL REMAIN IN THE MONEY MARKET

Tae-Yol Lee
(tylee@hri.co.kr)

The apparent situation in March's money market is quite similar to that in February. Short-term interest rates such as the call rate and RP rate stayed around 5.0% while long-term rates were 2.0~3.5%p higher. The government bond rate was around 7.0% and corporate bond yield was over 8%.

At the turn of the year, the movement of liquidity in the market used to be toward the investment trust companies, but it slowed down from February. The inflow to the investment trust companies reached 32 trillion won in January. This influx was caused by an expectation that the investment in investment trust companies would result in a yield higher than the savings account in commercial banks. Investment trust companies' strategy for high return is to invest short-term funds into long-term bonds. But this strategy tends to lead to a 'maturity mismatch problem.' In February, the government decided to impose restrictions on this investment behavior, which could possibly cause a liquidity shortage in the investment trust companies. Since then, the advantage of the investment trust companies' funds has been diminished and the liquidity movement is reversed to savings account of commercial banks, 9.8 trillion for February and 5.3 trillion during the first half of March. Meanwhile, the inflow to the investment trust companies dropped to just 7 trillion won in February and was reversed to outward in March.

Thanks to the central bank's intention to lower interest rates and stabilize inflation rate around 1.0%, the interest rates more or less stabilized recently. However, there still exist factors which can cause instability of interest rates in the future. First, the second stage of financial restructuring is known to include additional exits of merchant banks and life insurance companies. Second, a tremendous amount of government bonds(25 trillion won) is planned to be issued in the open market throughout this year. The size may inflate further as government is going to spend additional budget in order to boost the economy. Naturally, there arise worries of a "crowding-out" effect. Third, the foreign exchange market will be liberalized from this April; as a result, cross-border movement of money will become new factors of financial market instability.

One clear thing is that a low interest rate is a necessary condition for recovery of domestic economy. A flexible monetary policy responding to abrupt changes in the market and continued supply of abundant liquidity for money market are critically needed to meet this necessary condition. VIP

Table 1. Major Interest Rates

(End of Period, %)

	1997	1998	1999		
			Jan.	Feb.	March 31
Corporate Bond Yield (3 yr.)	28.98	8.00	8.13	8.65	8.10
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	4.88