

INTEREST RATES BEGIN TO REBOUND AS THE ECONOMY RECOVERS

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The downward trend of interest rates which began since March continued in the following month, breaking historical marks day after day. As of April 24, the call rate, 3-year corporate bond yield and 3-year treasury bond yield had dropped to 4.7%, 7.3% and 6.0%, respectively.

The Korean government's low interest rate policy and overflowing liquidity in the financial market together have played a key role in leading this fall in interest rates. At the end of March, the Bank of Korea (BOK) decided to change its policy direction and permit the call rate to enter the 4% range in order to induce the long-term rate to fall and, by doing so, push ahead the recovery of real economy. The BOK's policy change was made possible by the stability of the exchange rate and inflation rate. On the other hand, the low interest rate on bank deposits and the bullish stock market have directed the course of the liquidity flow to non-bank financial institutions since the end of 1998, which increased their demand for the long-term bonds.

Yet interest rates began to rebound almost up to 8% at the end of April. This was mainly due to the high possibility of government's

policy turnaround. Industrial production rose by 18.6% (year-on-year) during March, which indicates that the economic recovery is occurring faster than expected. Worried that low interest rates may result in increasing inflationary pressure through excessive consumption as well as a bubble in the stock market, monetary authorities began to consider inducing a hike in interest rates. This has discouraged further demand for bonds by the market players, and interest rates began to climb back up.

With growing inflationary pressure rising from the upward movement of international oil prices and the recovering pace of private consumption, interest rates are not expected to spiral down to the 7% range. On the other hand, to bolster the active stock market and boost investment and consumption the government is unwilling to let the interest rates soar above the current 8% level. Since the possibility is low that policy-makers will abandon the low interest rate policy in the near future, interest rates are not likely to experience drastic fluctuations out of the 8% range during this month. **VIP**

Table 1. Major Interest Rates

	1997	1998	1999			
			Jan	Feb	Mar	April
Call rate (1 day)	26.59	6.53	6.15	5.14	4.88	4.72
CD rate (91 days)	25.00	7.70	6.77	6.61	6.55	5.80
Corporate Bond Yield(3 yr.)	28.98	8.00	8.13	8.65	8.10	7.74
Treasury Bond Yield(3 yr.)	-	6.95	7.05	6.96	6.50	6.66

Source: Bank of Korea