POLICY SHAPES FUTURE OF INTEREST RATES

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In accordance with the government's decision to ease its policy to push interest rates down, interest rates began to rise from the end of April, heading up to 8.5%. Under the apprehension that the rapid economic recovery would increase the inflationary pressures, the monetary authorities resolved to give up inducing interest rate cuts and allow gradual elevation of long-term interest rates. In consequence, the understanding by market participants that rates have bottomed out has also contributed to pushing the rates up. Such understanding was based on the possibility of a domestic interest rate hike brought by increased money demand and on external factors such as rumors of rising US interest rates.

With the contracted corporate bond market, the recent interest rate trends seem more sensitive to the government's policy direction than to the supply and demand of the bonds. Two conflicting needs co-exist for the Korean economy: one to maintain low interest rates for the economic recovery and the other to raise them to ease inflationary pressures. Given the differing policy stands of the Ministry of Finance and Economy and the Bank of Korea, government officials have been under fire for making frequently conflicting statements concerning future interest rates, creating confusion among market players. The newly appointed cabinet has the immediate task of restoring consistency and credibility in its policy directions, so as to prevent a similar controversy from resurfacing.

As expectations for economic recuperation soar continuously, interest rates will be under pressure to rise; however, the future policy direction will be the primary determining factor of the interest rate movement. As economic outlook for the latter half of 1999 is brighter, a possible increase in money demand is posing pressure on interest rates to climb up. However, as the bourse bull run was watered down by the sudden elevation of interest rates in early May, calls for lower interest rates to buoy up the economy are gaining strength, which is expected to expand the optimistic outlook for future interest rates and offset the pressure to rise.

In conclusion, the future trend of interest rates will thus depend on whether the government lets long-term interest rates rise or switches back to the lower rate policy again. Taking into account the inflationary concerns and necessity to push forward the economic recovery, however, the rise and/or fall of interest rates is likely to be marginal, moving within the range between 8.0% and 8.5% (3-year corporate bond yield). VIP

Table 1. Major Interest Rates

(End of Period, %)

	1997	1998	1999				
			Jan	Feb	Mar	Apr	May 31
Call rate(1 day)	26.59	6.53	6.15	5.14	4.88	4.72	4.73
CD rate(91 days)	25.00	7.70	6.77	6.61	6.55	5.80	6.25
Corporate Bond Yield(3 yr.)	28.98	8.00	8.13	8.65	8.10	7.74	8.37
Government Bond Yield(3 yr.)	-	6.95	7.05	6.96	6.50	6.66	6.67

Source : Bank of Korea