

ECONOMIC INDICATORS DANCE TO JITTERY FINANCIAL TURMOIL

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In July, the market circumstances began to turn unfavorable at home and abroad. Market players fell into a psychological unrest, which resulted from sudden fluctuations in the major financial indicators. In consequence, the yields of 3-year corporate bonds and government bonds hit the highest mark of the year.

The financial turmoil was first set off by optimistic speculations on the economic recovery. Economic institutes in succession revised their forecasts of the annual economic growth rate from 4-5% to 7-8%. Such optimism agitated the market players with the possibility that the domestic interest rates could switch to an upward trend, backed by the increasing money demand and inflationary pressures. In addition, a massive amount of liquidity moved out of the bond market and rushed into the stock market. The movements were mainly initiated by the weakened soundness of investing in bonds and the expectations for high rate of yields in the stock market.

The credit crunch crisis of the Daewoo business group in late July aggravated instability in the financial markets. After Daewoo announced a plan for additional restructuring on July 19, worries that the economy may face another financial crisis similar to that of 1997 seized investors with a panic. In particular, customers of the investment trusts, which hold 77% of corporate bonds amounting to 28.6 trillion won and company papers issued by Daewoo,

raced to demand them to make "repurchases", or in other words, to buy back the beneficiary certificates. The investment trust companies, which are the major bond buyers in the bond market, could not help but sell their bonds at hand to fund such repurchases. The corporate and treasury bond yields skyrocketed by more than 150 basis points within just one week and reached 9.5% and 8.7%, respectively.

Thanks to the prompt policy measures by the government, the market players' psychological panic subsided tentatively and the financial markets are gradually getting out of the sudden shock. But the situation has not fully settled yet. The market is still haunted by worries about Daewoo's debt problems and restructuring process of the entire corporate community in the future. Inflationary pressures from the rapid economic recovery also did not shrink. Industrial production increased by a surprising 29.5% year-on-year and the manufacturing operation ratio recorded at 79.8% in June, both approaching the pre-crisis levels. In addition, foreign variables are highly likely to remain as disturbing factors, such as the possibility of the Chinese yuan's devaluation, the U.S. interest rate hike, and the recurrence of economic crisis in Latin American countries. Therefore, it is very possible that the recent financial unrest will last for some time and the corporate bond yield will stay around 9.0% in August. **VIP**

Table 1. Major Interest Rates

	1997	1998	1999						
			Jan	Feb	Mar	Apr	May	Jun	Jul 28
Call rate(1 day)	26.59	6.53	6.15	5.14	4.88	4.72	4.73	4.85	4.69
CD rate(91 days)	25.00	7.70	6.77	6.61	6.55	5.80	6.25	6.35	7.08
Corporate Bond Yield(3 yr.)	28.98	8.00	8.13	8.65	8.10	7.74	8.37	7.96	9.06
Government Bond Yield(3 yr.)	-	6.95	7.05	6.96	6.50	6.66	6.67	7.20	8.26

Source : Bank of Korea