UNBALANCED MARKET MAKES TWO-DIGIT INTEREST RATES

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In spite of the government's policy reactions, the financial turmoil triggered by the Daewoo crisis became worse in August. Especially, worries about the liquidity shortage of investment trust companies (ITCs) have spread widely. ITCs had to sell their bond holdings to meet the growing redemption calls for their bond-type beneficiary certificates, which pushed up the long-term interest rates to a two-digit level, the highest of this year.

According to the Bank of Korea (BOK), a total of 33.2 trillion won has been withdrawn from bond-type beneficiary certificates since May. The Daewoo Group's debt crisis has accelerated the cash outflow, owing to the sizable amount of ITCs' share in the bond market. ITCs have been holding 77% of a total of 28.6 trillion won's worth of the corporate bonds and commercial papers Daewoo had issued. Customers' redemption calls resulted in an outflow of 1.8 trillion won in July, followed by 21.0 trillion won in August (until the 25th). As a result, the outstanding balance in bond-type funds fell below 200 trillion won, standing at 188.8 trillion won as of August 31. On the contrary, banks feasted on the sudden money rush that fled ITCs; deposits at bank accounts have increased by 18.8 trillion won since June.

To make things worse, Daewoo's workout programs constrained ITCs from receiving the principal of their Daewoo bond holdings, causing more rapid money outflow from ITCs' investment funds. In consequence, the massive money outflow weakened their cash availability to buy bonds and forced them to cash in other bond holdings for redemption orders. The sudden imbalance in demand-supply condition lifted corporate and government bond yields to 10.27% and 9.21% respectively, this year's highest.

The future trend in interest rate movement is definitely up to whether the investors will ease on redemption. Although the current financial turmoil would be settled down, however, it is quite difficult to expect long-term interest rates to fall amid unfavorable circumstances other than the Daewoo problem at home and abroad. These factors include the growing inflationary pressures along with the rapid economic recovery and the mounting possibility of an additional U.S. interest rate hike. Therefore, it is quite likely that the corporate bond yield will stay around 10.0% in September. VIP

Table 1. Major Interest Rates

(End of Period, %)

	1997	1998	1999							
			Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Call rate(1 day)	26.59	6.53	6.15	5.14	4.88	4.72	4.73	4.85	4.67	4.75
CD rate(91 days)	25.00	7.70	6.77	6.61	6.55	5.80	6.25	6.35	7.21	7.35
Corporate Bond Yield(3 yr.)	28.98	8.00	8.13	8.65	8.10	7.74	8.37	7.96	9.23	10.27
Treasury Bond Yield(3 yr.)	-	6.95	7.05	6.96	6.50	6.66	6.67	7.20	8.45	9.15

Source : Bank of Korea