

INTEREST RATES FALL AMID DEBATES ON INFLATION

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Even in the face of the ongoing financial unrest and policy debates on inflation, the long-term interest rates kept falling to the 8% range in October, thanks to the buying power of the Bond Market Stabilizing Fund (BMSF).

Many experts warned the monetary authorities to adopt a preemptive policy against the growing inflationary pressures. The warning revived debates on a policy changeover to tight monetary policy and daunted the market players with a possible interest rate hike.

However, the long-term interest rates stabilized on the downward trend, thanks to the government's strong will to keep them low, and re-entered the 8% range for the first time since late last July. The government thought it inevitable to maintain a low interest rate policy in order to soothe the current financial unrest and strengthen the foothold of economic recovery and restructuring. In particular, the BMSF has directly contributed to balancing the demand-supply condition and lowering the long-term rates by purchasing about 10 trillion won's worth of bonds since last September. Yet the positive effect of the BMSF is not strong enough to cure the bond market paralysis completely. On the contrary, small- and medium-

sized companies still have difficulty in funding through direct and indirect financial markets because of the BMSF's tendency to buy high-quality bonds.

There will be several disturbing factors in the bond market in November. Above all, the customers of ITCs can redeem their bond-type beneficiary certificates with guarantee of 80% for Daewoo-related bond holdings after November 10. Still, the possibility of massive redemption calls is quite low because the government's stabilizing measure is expected to ease the market players' psychological unrest about restructuring of the Daewoo Group and ITCs. Second, the market players think that the long-term interest rates may not fall below 8%. They regard the current level of interest rates as a bottom as the economy continues to recover at a rapid speed. Third, it is highly possible that the debate will reactivate policy shift to a tight monetary policy at the year-end, when the current financial unrest is expected to be settled down to a moderate degree. In spite of these factors, however, the government's will and the continuous bond purchases by the BMSF can keep the long-term interest rates to stay around 8% in November. **VIP**

Table 1. Major Interest Rates

	1997	1998	1999					
			Q1	Jun	Jul	Aug	Sep	Oct
Call rate(1 day)	26.59	6.53	4.88	4.85	4.67	4.75	4.80	4.64
CD rate(91 days)	25.00	7.70	6.55	6.35	7.21	7.35	7.70	7.00
Corporate Bond Yield(3 yr.)	28.98	8.00	8.10	7.96	9.23	10.27	9.95	9.02
Treasury Bond Yield(3 yr.)	-	6.95	6.50	7.20	8.45	9.15	9.03	8.18

Source : Bank of Korea

(End of Period, %)