

IMPACT OF U.S. RATE: WEAK ON KOREAN BOURSE

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The U.S. economy has demonstrated an exceptionally sound growth phase with low inflation. Although investors could observe unexpected rise of CPI or drastic decline of stock indices a few times, productivity has steadily improved and manufacturing sectors, which were in difficulty due to the reduced world merchandise demand, have revived.

However, some tentative signs of moderation have recently emerged. For example, housing starts is declining and retail sales momentum has been fading as the fourth quarter approaches, and those trends seem to continue. September's employment cost index and CPI were cooled down, and new home sales drastically fell as mortgage rates rose. Interest rates have soared by about 150 bp during the past year, and fixed-rate mortgages are now hovering close to 8%.

Third quarter GDP rose at a 4.8% rate, but it will turn out to be transitory. Inventory investment increase and small reduction of trade deficit played a key role in raising GDP growth rate; however, if domestic demand which takes the largest portion of GDP moderates, the recent performance will change its direction. In other words, consumer spending is another area showing signs of moderation. The recent weekly chain-store sales data suggest that spending growth has peaked. Although Christmas season will lead strong spending momentum, growth in consumer spending should slow from a 4.5% annual rate in the third quarter to a moderated pace of 3.5% for the fourth quarter and 3.0% for 2000.

The obstacle for moderation scenario is proved to be payroll employment. It could edge up by more than 300,000 workers in October and tight labor market can stimulate the Fed's preemptive motives to raise the rate. With Fed's such attitude to monetary policy, an additional rate hike is expected on Nov 16. Generally, the rate hike has led the dollar to reevaluate, but nowadays investors keep their eyes on its negative effect on the stock market. So Greenspan's speeches on inflationary pressures send much stronger signals to the market than those at any other time.

However, the rate concern seems not likely to significantly affect U.S. financial markets because 25 bp hike would be reflected on stock market one or two weeks before that case happens. Since leading indicators like CPI, new home sales, non-farm payrolls, productivity and NAPM indices are expected to show signs of moderation, the Fed is expected to raise the rate only by 25 bp, and market players and Fed watchers can read this latent move in advance.

Recently, it is true that Korea's domestic stock market repeatedly shows synchronized movements with those abroad, especially the NYSE. Accordingly, the KOSPI 200 index has had high correlations with the Dow Jones and S&P 500 indices. As long as the NYSE stays moderate, the KOSPI will not receive negative impact from abroad. That means a 25 bp hike in November will not considerably affect the U.S. market and consequently the Korean stock market. **VIP**