INFLATIONARY CONCERNS PUSH RATES UPWARD

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Due to the growing inflationary concerns along with the rapid economic recovery and the imbalance between supply and demand, the long-term interest rates have rebounded up to nearly 10% in November.

During the third quarter this year, Korea's gross domestic product (GDP) grew by 12.3% compared to the same period last year, the highest in the past 10 years. The faster-than-expected growth rate raised concerns of economic overheating and inflationary pressures. The debates on using the adjustment of interest rates as a preemptive inflationary measure threw market players into confusion about the future trend of the interest rates and were reluctant to buy bonds. The bond market stabilization fund (BMSF) assumed a wait-and-see attitude because higher interest rates will cause capital losses for the commercial banks and insurance companies that offered money to the BMSF.

Due to contracted bond-buying capacity, the government's plan to issue 10.9 trillion won's worth of government bonds put the demand-supply conditions off balance. The government originally planned to issue 5.9 trillion won government bonds and 5 trillion won foreign exchange stabilization bonds during the remainder of the year. A massive issuance of government bonds is feared to crowd corporate bonds out of the market and push up their yields.

Against this backdrop, the long-term interest rates retained the downward trend from October, despite unfavorable market circumstances, and began to rebound in November. The corporate bond yields jumped up to late 9% range, the government bond yields up to mid-8% range.

As soon as the interest rates showed an upward trend, the government immediately took positive policy measures to curb further rise, believing it is too early to worry about an overheating economy and inflation. Besides, higher interest rates would not only agitate the financial market sentiment regarding investment trust companies but also weaken the foothold of economic recovery and delay the ongoing restructuring. Above all, the government expressed its strong will to keep low interest rate policy in order to soothe the market players' psychological unrest. Also, the government decided to reduce the amount of government bonds to be issued this year to only 1.9 trillion won's worth and only 1.3 trillion won's worth of foreign exchange stabilization bonds. Moreover, it urged banks and insurance companies to promptly accumulate an additional 10 trillion won for the BMSF to buy more bonds.

Thanks to the government's policy, it is likely that the long-term interest rates will be able to remain at the one-digit level until the year-end. Considering the rapid economic growth and growing inflationary pressure, however, it is difficult to expect the interest rates to stay low for a long time. VIP