WON WILL BE STRONG

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Oversupply of Greenback

The won-dollar rate fell in July and ended trading in Seoul at 1,208 (closing price) on July 27, the lowest level since December 1997. The main reasons behind the stronger won rate were the current account surplus and the dollar inflows to pay for the assets of local companies acquired by foreigners. In fact, the oversupply of dollars was so great that it overwhelmed the effect of the weakening yen. However, most analysts agree that the won's upward movement is not justified by economic fundamentals. Therefore, the Bank of Korea (BOK) decided to intervene in the foreign currency market, and as a result, the won-dollar rate rose again to 1,258 (closing price) the next day.

Korea's current account surplus was $3.43 billion in June. While this was down from May's $4.26 billion, it was still a massive improvement on the $223 million deficit in June last year. As with many recent trade numbers around the Asian region, the big surpluses are coming as a result of a sharp fall in imports more than an increase in exports. In Korea's case, exports fell 11.5 percent while imports dove 37.7 percent. If the oversupply of foreign currency persists for the time being, the won-dollar rate will soon fall further to under the 1,200-won level unless there is intervention.

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However, the Korean won's steep rise against the dollar, coming at a time when the Japanese yen and most other Asian currencies are falling, is threatening to undermine the basic competitiveness of Korea's key export industries. The sectors to be hit hardest include the apparel, home appliance and automobile industries, which compete head-to-head with their Japanese counterparts in international markets. Other sectors that will probably face difficulties are the machinery and shipbuilding industries, which will find it hard to receive orders during the second half of this year. It seems that the won's value has already passed the critical level for domestic exporters to remain competitive.

The won's rise should continue further due to the declining demand of the U.S. dollar, reflecting the sharp shrinkage in imports until this October when imports are expected to increase because of the Government's expenditures to boost the depressed economy.

Optimal Level Is Over 1,250

As long as there is no intervention by the foreign exchange authorities, it will only be a matter of time before exchange rate falls below 1,200 won. The 1,250-level is generally considered the first line of defense for Korean exporters seeking to maintain minimum price competitiveness overseas. To make matters worse, the Japanese currency's plunge against the U.S. dollar, now hovering around 143 yen, would deepen the adverse impact on Korean exporters as more than 40 percent of the country's key export products overlap with the Japanese products in global markets. In this sense, the Government has little choice but to try to absorb the surplus dollars in the foreign exchange market and keep the exchange rate at a steady level. VIP