WON MOVEMENT WILL BE DEPENDENT ON YEN

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Stable Domestic Market

The domestic foreign exchange market was relatively stable for most of August in spite of the external turbulence caused by the sliding yen and the 34% devaluation of the ruble, with the exchange rate staying around 1,350 won/dollar. Toward the end of the month, the local currency rallied, jumping to 1,290 won to the dollar. The reason for the won's surge was largely the yen's increasing strength against the dollar, based on Tokyo's assertion that it was ready to support its currency and also the capital movement from the U.S. to Japan. Another reason for the won's increasing strength was Korea's growing foreign exchange reserves Korea's usable foreign exchange reserves surpassed $40 billion for the first time in history as of August 15. The official reserves amounted to $43.91 billion, including $3.54 billion deposited with overseas branches of Korean banks.

The government will maintain its efforts to replenish its usable foreign exchange reserves to more than $50 billion by the end of this year to minimize simmering jitters in the market. The local exchange market can lose its hard-won stability at anytime due to the looming possibility of the devaluation of the Chinese yuan and the continued weakness of the yen. To strengthen the domestic market so that it can withstand the shocks from possible Asian financial turmoil, the government will seek new loans from abroad, for example, through the additional issuance of sovereign bonds. The government is seeking to offer state bonds worth $5 billion this year, but will sell them after prices have stabilized in light of the recent surge in the spreads on sovereign bonds sold in April. Within this year, it plans to collect about half of the $10 billion in foreign-currency loans by the Bank of Korea to domestic financial institutions. The Finance Ministry will also push for receiving the $8 billion in second-line defense loans from 13 advanced nations which was originally pledged as part of the IMF bailout package. In addition, to help prepare for possible changes in the yuan, the yen and Hong Kong dollar, the Ministry will work out a more diverse policy mix regarding international dollar dealings.

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Yen's Movement is Important

According to HRI's econometric model, the won is expected to follow one of four scenarios. The first scenario is that the yen falls to around ¥130/$ with a change in the market sentiment because of the Japanese government's foreign exchange market intervention. In this case, the exchange rate will decline to about 1,200 won/dollar. The second scenario is that the yen stays at about ¥140/$. In this case, the exchange rate will stabilizing at 1,250~1,300 won/dollar. The third scenario is that the yen remains about ¥150/$. In this case, the won will depreciate to between 1,350~1,450 won/ zdollar. The fourth scenario is that the yen remains on a downward trend and falls to about ¥160/$. In this case, the won would depreciate to 1,400~1,500 won/dollar. In all these scenarios, the assumption is that there is no devaluation of the Chinese yuan. As of now, scenario two is expected to take place in September. That is, the won will probably be stable at 1,250~1,300 won in September because of the stable domestic market and stable global market. VIP