

WON WILL FACE PRESSURES OF APPRECIATION

by Min-kyoo Jun  
(e-mail: mkjun@hri.co.kr)

Between August and November, the won/dollar exchange rate hovered between 1,300 and 1,400. But since breaking into the 1200s in mid-November, the won/dollar rate has sharply declined, finally falling below 1,200 on December 21, the lowest point in the year.

*Background of Won's Appreciation*

Throughout the year, there has been an oversupply of dollars resulting from the current account surplus, IMF and related loans and increased foreign investment, among other things. The accumulated current account surplus for the year through November is \$37.2 billion while the capital account recorded only a \$1.4 billion deficit. The surplus in the current account has brought about an oversupply of dollars in domestic exchange market.

Even so, the oversupply of dollars in itself cannot explain the sharp decline of the won/dollar exchange rate since mid-November. The reason is that until recently, uncertainty about the possibility of the reappearance of a current

account crisis and about the instability in the international financial markets has prevented the won/dollar exchange rate from falling below 1,300 in spite of the oversupply of dollars; however, these factors or uncertainties are weakening, which is invoking won's appreciation.

The U.S. Fed's interest rate cuts, the strong yen in international markets, the unstable economic situation in Latin America, and the influx of foreign stock investment into Korea are other factors which have encouraged the Korean won in the domestic financial market. The recovery of domestic economic indicators such as the increase in industrial production and the good performance in exports of semiconductors and automobiles has also attracted foreign portfolio investment. In sum, the possibility of economic recovery has reduced the risk premium charged over of the Korean won.

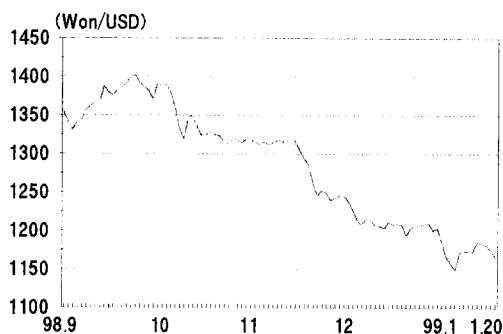
*Exchange Rate Will Remain Around 1,200 for a While*

It seems unlikely that the won/dollar exchange rate will bounce back up to 1,300 or higher since the factors behind a possible won depreciation are weaker than those supporting appreciation. But the government will intervene in the exchange market to prop up the dollar in order to prevent Korean goods from losing their price competitiveness. The government has another reason to intervene. The government paid back the initial \$2.8 billion portion of the IMF loan due in December as scheduled, and is expected to repay an additional \$ 1 billion both in January and again in February. To avoid a

(continued on p.11)

*"It seems unlikely that the won-dollar exchange rate will bounce back up to 1,300 or higher since the factors behind a possible won depreciation are weaker than those supporting appreciation."*

Recent Movements of Won/\$ Exchange Rate



## Won Will Appreciate

M.K. Jun

*(Cont'd from p. 9)*

decrease in foreign reserves, the government will buy dollars in the market.

In spite of the government's efforts, however, a rise in the exchange rate seems unlikely since the oversupply of dollar will not disappear in the near future. In fact, even though the government is expected to intervene, the possibility that the exchange rate will fall down to the low 1100 range cannot be ruled out since pressures to pull the exchange rate down are so strong. The continued current account surplus, the inflow of foreign investment, and the possi-

ble upgrade of Korea's credit ratings are factors behind the won's appreciation, and the government's intervention may not be able to sufficiently prop up the dollar in face of these factors in the long run. If government's intervention fails, there is a possibility that the exchange rate will fall sharply down to 1,100 because of the disappointment of the market participants who have hesitated to sell dollars. Domestic companies began to lower their dollar positions in the form of resident foreign currency deposits. They will cut their foreign exchange losses by selling their dollars when the exchange rate descends below 1,200. **VIP**