

DETERMINING FACTORS IN THE FOREIGN EXCHANGE MARKET

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Comparison of Pre-Economic Crisis vs. Post-Economic Crisis

The stability of the foreign exchange rate within the range between 1,210 and 1,220 won per dollar during the last two months was jolted when the won/dollar rate dropped back to 1,190s once again. On April 30, the won/dollar rate was dragged further down to 1,188 won by the foreign capital inflows in the Korean stock market and the weakness of the government's indirect intervention. The main factors determining the foreign exchange market seem to have changed slightly after the economic crisis. Before the economic crisis cropped up, it seemed that the determining factors of the exchange market were the current account deficit and countervailing government intervention in the market. As the current account deficit deepened in 1996, the government tried to block the won's depreciation by supplying dollars in the market. However, this policy action resulted in a distortion of the exchange rate and thus contributed to the outbreak of the foreign exchange crisis later in 1997.

Since the crisis, a floating exchange rate system has been introduced, and the determining factors in the market have changed. The drastic depreciation of the won led a massive current account surplus in 1998. As the domestic financial market and stock market regained stability, foreign investors returned to the Korean market. The determining factors in these days are the current account surplus, foreign capital

inflows, and government intervention aiming to deter the won's excessive appreciation. In particular, foreign direct investment and portfolio investment have recently emerged as new driving forces pushing up the won's value.

Factors Determining the FX in 1999

The Korean government and the BOK are trying to harness the soaring won in order to sustain the price competitiveness of Korean export products. While business associations are calling for a 1,300 won/dollar or higher rate in order to maintain the price competitiveness of Korean products, the government and BOK's target range seems to be around 1,200~1,250 won/dollar. They are inducing government-owned corporations and commercial banks to buy dollars in the market and to repay their foreign debts. However, the current account surplus will continuously work toward the won's appreciation, with an expected surplus of 20~25 billion dollars. In addition, it is expected that foreign investment for the year will amount to 13 billion dollars, inclusive of stock and bond investments. All in all, during 1999, the market will probably witness an oversupply of dollars of around 10 billion dollars. Throughout the year, appreciation pressure from the oversupply of dollars will be met by countervailing government intervention to restrain the won. Furthermore, the daily trade volume of the exchange market is expected to increase the liberalization of the foreign exchange market, along with the short-term volatility of the exchange rate. **VIP**