EXCHANGE RATE SLOWLY DROPPING

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The won/dollar exchange rate, reflecting the government policy to weaken the won, entered the 1,200 won range, only to fall down back into the 1,100 won range after the dollar supply surpassed demand in the foreign exchange market. Although the yen/dollar exchange rate reached over 120 yen backed by the dollar's strength, the won/dollar exchange rate showed a downward trend, recording at 1,186 won/$ as of May 31. Accordingly, the 1,000 won per 100 yen line was broken at the end of April, dropping into the 970 won area.

Increasing foreign capital invested in Korean companies, the government's weakening ability to affect the foreign exchange market and the continuing current account surplus are the main causes of slipping won/dollar exchange rate. First, proceeds from overseas asset sales by companies including the Anam and LG business groups have passed 500 million dollars, playing a decisive role in dropping the won/dollar exchange rate. Second, the decline in the policy-driven purchase of dollars through the central bank was interpreted by market players as the weakening of the government's will to intervene in the foreign exchange market, increasing the dollar supply by banks and companies. The size of foreign currency deposits, which stayed at the 11 billion dollar level early this year, has now shrunk to the 9 billion dollar level. Third, the current account is continuously recording surpluses, lowering the exchange rate: current account surplus was 6.5 billion dollars in the first quarter of 1999.

The drop in the won/100 yen exchange rate has been more extensive than the falling of the won/dollar exchange rate. There are two main problems for the downward movement of the won/100 yen rate. First, it will reduce Japan-bound exports by worsening the profitability of Korean firms. Second, it will indirectly dampen total exports by weakening the price competitiveness of Korean export commodities in areas where Korea and Japan compete head-to-head, such as electronics, automobiles and machinery. In particular, such commodities take up more than 40% of Korea's total exports. According to a survey by KOTRA, the 990 won per 100 yen range needs to be sustained to satisfy the targeted amount of exports.

The future won/dollar exchange rate is forecast to fall steadily, due to the continued over-supply in the foreign exchange market stemming from foreign capital influx into financial institutions and the current account surplus. In particular, a substantial amount of foreign capital is expected to come in the second half of 1999, adding more pressure on the Korean won to fall. The Korean government will continue to intervene indirectly to try to stabilize the Korean currency and prevent sudden flooding and drainage of foreign currency, even with limited effects. Moreover, since the extent as well as the direction of foreign exchange fluctuation have a deep impact on the economy, the government may well intervene in the foreign exchange market to alleviate volatility. At the same time, Korean businesses should prepare themselves by effectively implementing methods to minimize foreign exchange risks, such as swap transactions utilizing the foreign currency future market. VIP