

WILL WON/DOLLAR RATE KEEP RISING?

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The Rate Bounces up to 1,210-Won Level

With its stable movements within the range between 1,190 won and 1,200 won/dollar as of mid-September, the won/dollar exchange rate has sharply risen above 1,210 won because of the instabilities in financial markets since the announcement of Daewoo's disintegration. Although the dollar showed relative weakness against the Japanese yen on account of foreign portfolio flows into Japanese stocks, the won/dollar exchange rate showed an upward trend. Concomitantly, the won/100 yen exchange rate reached over 1,150 won, this year's highest.

Outflowing foreign capital, speculative offshore purchasing of dollars and the government policy to keep the won slightly weak are the main causes of the rising won/dollar exchange rate. First, the cash outflow from the stock market has accelerated since the Daewoo problem broke out, amounting to 2 billion dollars as of mid-September. This played a decisive role in raising the won/dollar exchange rate. Second, the speculative dollar purchase by offshore brokers, anticipating additional rises in the won/dollar exchange rate, have increased in Seoul's foreign exchange market. In particular, the instability of the financial markets resulted in the speculative demand of dollars. The size of foreign currency deposits, which shrank to 9 billion dollar, has now increased once again, reminding the period immediately after the foreign exchange crisis in 1997. Third, the policy-driven dollar purchases through the

state-owned banks weakened the won's value, pushing the exchange rate upward. The banks' demand for dollars in order to repay their foreign debts and the decreased current account surplus in August retained the upward trend of the won/dollar exchange rate.

Mild Drop in the Near Future

The won/dollar exchange rate is expected to fall slowly since factors supporting the won's appreciation are stronger than those leading possible won's depreciation in the months to come. The former factors are the current account surplus, foreign capital inflow into financial institutions and yen's appreciation. Although the volume of surplus trend of current account will decrease in the annual comparison, it seems likely that the current account surplus will continue hereafter. If the international credit rating agencies such as S&P and Moody's upgrade Korea's sovereign credit ratings as is expected, foreign direct and portfolio investment will increase significantly. The downward pressure on the won's value will be lessened by inflow of foreign investment. If the yen remains continuously strong against the U.S. dollar for the time being, the won may become appreciated as a side effect. In fact, there is a consensus among analysts on continued intermediate term yen appreciation, led by foreign purchases of Japanese equities.

Future financial market may be somewhat turbulent due to the Daewoo's debacle, depending upon the successful execution of policy alternatives. **VIP**