

INCREASING INFLUENCE OF NDF MARKET

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Won/Dollar Rate Dropping Back to the 1,190s

Stabilizing between 1,204 and 1,205 won for most of October, the won/dollar rate fell down back to the 1,190 won level once again at the month's end. But further appreciation was blocked by the wariness of the government's indirect intervention in the market. As the government confirmed the size of Daewoo-related bonds and loss liability principles, expectations for the resolution of Daewoo's problem led to the won's appreciation. In addition, foreign funds returned to the Korean stock market and were converted for stock purchases, thus increasing the dollar supply. Above all, speculating traders in the NDF (non deliverable forward) market expected the won/dollar rate to drop and so decided to sell dollars.

Since the liberalization of the foreign exchange market on April 1, 1999, the daily average trade volume of NDF market has sharply increased from 0.1 billion dollars to 0.3~0.4 billion dollars in October. This is because the NDF, established in Hong Kong and Singapore, opened a new market in Korea. Thus, the forward won/dollar exchange rate determined in the NDF market has begun to largely affect the spot exchange rate. This is due to the banks' and foreign investors' movement in the spot exchange market to hedge the risk of exchange transactions in the NDF market. As the speculating traders had actually bought dollars in the spot exchange market and sold them in the NDF market, the won/dollar exchange rate had sky-rocketed to the neighborhood of 1,230 won in September.

The Possibility of Sudden Change in the Exchange Market

If NDF transactions increase on a large scale in a short period of time, it is possible for the won/dollar exchange rate to suddenly fluctuate with NDF's transactions. The daily trade volume of foreign currency among banks increased by 3.4 billion dollars in the third quarter of 1999, growing by 56% in comparison with the previous quarter. Although the volume of spot transactions sustained 1.9 billion dollars in the third quarter of 1999, the volume of swap transactions increased to 1.5 billion dollars in the same period, in order to hedge the transaction risk in the NDF that is threefold the amount in the second quarter. In particular, transactions in the NDF market and foreign portfolio investment in the domestic stock market are highlighted as factors determining the foreign exchange market. This means that the influence of short-term capital in the foreign exchange market is increasing furthermore.

The future won/dollar exchange rate may head downward for a while in spite of the unstable factors such as the restructuring issue of investment trust companies and a possible rise in U.S. interest rates, as the unstable factors will be overwhelmed by the oversupply of dollars in the foreign exchange market. In particular, current account surplus and foreign investment will continuously work as driving forces pushing up the won's value. **VIP**