STRONG WON CONTINUES?

Hee-Sik Jeong
(hsjoung@hri.co.kr)

Won/Dollar Rate Sharply Decline to 1,150 Level

Since the sharp decline in November, the won/dollar exchange rate stabilized between 1,159 and 1,160 at the end of November. The won/dollar rate momentarily fell down to 1,155, but further appreciation was blocked by the government's indirect intervention; the government induced government-owned banks and public enterprises to buy dollars in the market. Nevertheless, the oversupply of dollars exerted pressures on won's appreciation.

Increasing foreign portfolio capital invested in the domestic stock market, speculative dollar purchases in the NDF market and abrupt appreciation of the yen/dollar exchange rate were the main causes for the slipping won/dollar exchange rate. Foreign capital net influx to the domestic stock market has passed $2 billion in November, playing a decisive role in depressing the won/dollar exchange rate. The rumor proceeding from Thrunet's listing on the Nasdaq could be transferred to the domestic exchange market resulted in the won's further appreciation. Speculative traders in the NDF market who expected the won/dollar rate to drop have sold $500 million in just one day in Hong Kong and Singapore. At the beginning of this year, some foreign banks forecast that the won/dollar exchange rate would approach the 1,100-won level in 1999. The yen/dollar rate approached the 100-yen level, owing to the strong signs of recovery in the Japanese economy and the capital flow from the U.S. into the Japanese stock market. Additionally, the annual current account surplus has created a dollar oversupply situation in the domestic exchange market.

1,150 Level to Be Sustained until the Year-End

It seems unlikely that the won/dollar exchange rate will fall down to 1,150 or lower, since the supply and demand of dollars in the foreign exchange market is going to show a temporary balance in December. The repayment of foreign debts by the government and businesses, and the banks' demand for dollars in order to provide for losses denominated in foreign currencies are major factors of demand in the market. In fact, it is expected that debt repayment by the government and companies next month would amount to $2.5 billion. Banks' demand for dollars would amount to $1.5 billion. In the supply side, the monthly current account surplus is continuously posting above the $2 billion level. In addition, upward revisions of Korea's sovereign credit ratings are expected to increase foreign direct investment and portfolio investment to $2 billion.

Above all, the government will intervene in the exchange market to prop up the dollar in order to sustain the price competitiveness of export products. According to a survey by the Bank of Korea, a 10% fall in the won/dollar exchange rate would result in a 16% decrease of the operating profit for export businesses.

However, in spite of the government's efforts, a drop in the exchange rate seems likely, since resolving the dollar oversupply situation seems difficult in the long run. The continuing current account surplus and the inflow of foreign investment are factors behind the possibility of won's appreciation. VIP