

Comment

# Macro Issue

Korean Economy

May 13, 2008

## Won Tumbles Again Against the Dollar

### Won plummets on sustained trade deficit from surging oil prices

We attribute the won's depreciation in 2008 mostly to a current account deficit on the back of surging oil prices. The won is highly likely to be swayed by oil price fluctuations in view of Korea's heavy reliance on oil imports compared to its GDP. On top of this, increased currency hedging and short-term lending in foreign currency amid remaining concerns over the credit crunch should further widen foreign exchange rate volatilities, going forward.

We believe the concerns over the credit crunch which drove won's sharp depreciation in March have abated. The global financial markets have stabilized, the yen carry trade unwinding has lessened as carry currencies such as the yen and the Swiss franc are not as strong as in March, and foreign investors have significantly moderated sell-off in the domestic equity markets.

### Won unlikely to weaken further

We expect the won not to weaken further against the dollar on an expected increase in dollar supplies coupled with the current account balance expected to see improvement. Despite uncertainties over the current account balance due to high oil price volatilities, we anticipate the current account to improve, going forward. We expect it to be in balance or show a modest surplus unless Dubai crude oil exceeds US\$130/barrel on average from May.

### Current account balance hit by high oil prices

Nonetheless, we don't anticipate the won/dollar exchange rate to fall below W1,000 any time soon given: 1) the current account is expected to have a modest surplus; 2) foreign currency hedging for ship exports; 3) oil price volatilities; and 4) the government's preference for a weak won. Actual US dollar inflow from ship exports should be slightly lower than total export value due to foreign currency hedging. This implies that the actual current account should be just in the red even if the current account appears to be balanced in terms of figures.

### Weak won to fan inflationary pressures

The weak won suggests that inflationary pressures are unlikely to subside soon. The high inflation rate of 4% is expected to continue into 3Q08. During this period, an interest rate cut is unlikely.