Starting with an exchange rate for the US Dollar and the South Korean Won on September 26th of 1USD=1159.42KRW, the spot exchange rate for the US dollar and the South Korean Won on November 21st, 2008 was predicted to be 1USD= 1187.13KRW, based partly on past performance of the currency and partly on forecasts from other financial experts. The spot exchange rate at noon EST on October 24th was 1USD= 1411.83KRW (OANDA.com), however, which is a weaker value for the Won than originally predicted. Based on that and other actions by Korean authorities, it must be stated that the earlier prediction appears to be unrealistic and will not hold.

Factors Indicating a Weaker Won

The current worldwide economic crisis which began in the U.S. affects the South Korean economy most severely for two main reasons. First, South Korea has an export-dependent economy, so that the country's economic health is determined to a large degree by the economic health of its trading partners. (Forbes/Reuters, 23 October, 2008) Second, the Won is not a fully-convertible currency and is tied to the U.S. Dollar, preventing investors from cross-hedging with potentially stronger currencies like the Japanese Yen. (Michell, 2008) Korea's major exporting business, such as Samsung, KJ Pretech, and others have had their foreign currency hedge programs ruined by the extreme volatility of the dollar as well as the Won, and are thus holding their dollar assets rather than exchanging them. (Sydney Morning Herald/Bloomberg, 20 October 2008) This is one factor that reduces the amount of dollars in the financial system and helps to weaken the Won.

Even though financial experts were predicting in September that key interest rates in Korea would remain stable (Forbes/Thomson, 5 September 2008), the Bank of Korea reduced its benchmark rate by 0.25% earlier this month, the first reduction since 2004, as part of a series of economic stimulus measures. (Forbes/Reuters, 23 October 2008) With regard to interest rates, the BOK is faced with a dilemma: lowering the rate helps to loosen tight credit markets and stimulate lending, but may cause inflation which weakens the currency. Raising rates helps to reduce or at least control price inflation, which strengthens the currency but further tightens credit. Although the stimulus measures also include large infusions of currency into the financial system, which helps alleviate the negative effect of lower interest rates on the value of the Won, Korean financial markets have not reacted positively, which indicates business activity that would be the best cure for a weak Won is not yet increasing. (Forbes/Reuters, 23 October 2008)

Conclusion

As was pointed out in the conclusion to the first part of this exercise, there is no reliable method for forecasting exchange rates over a short period of time (Krugman & Ostfeld, 1994), and the decline of the Won against the dollar far beyond the prediction demonstrates this. While the stimulus measures that have been taken by the Bank of Korea in concert with other central banks around the world may yield positive benefits, the term in which they would have an effect is almost certainly much longer than a month. Therefore, it must be concluded that the earlier prediction of 1USD= 1187.13KRW was far too optimistic, and that the Won will be much weaker than that on 21 November 2008.

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