On September 26, 2008 the South Korean Won, which at that time had a spot rate of 1USD= 1159.42KRW, was predicted to weaken by November 21, 2008 to 1USD= 1187.13KRW. By October 24, 2008, however, the exchange rate had already far exceeded the November forecast, with the Won falling to 1USD= 1411.83KRW. The actual spot exchange rate as of November 21, 2008 has reached 1USD= 1495.44KRW (OANDA.com), a variance of over 25% from the original prediction. While the original prediction was at least correct in forecasting that the Won would be weaker than its September spot rate, the degree of the decline was not anticipated.

Where the Forecast Went Wrong

The most significant error made in this forecast, which was also made by financial experts who expected that interest rates in Korea would remain stable (Forbes/Thomson, 5 September 2008), was in not anticipating that the Bank of Korea would take drastic action on interest rates to try to stimulate faltering credit and equity markets. The Bank of Korea lowered its key rate three times, on October 9, October 27, and November 7, lowering the rate overall from 5.25% to 4%. (International Herald Tribune, 7 November 2008) Lowering interest rates helps stimulate spending and credit, but can cause inflation which weakens the currency. In present circumstances, however, when spending by consumers and businesses is reduced, price deflation becomes a problem, and so lowering interest rates is necessary. (Krugman & Ostfeld, 1994) Even though lowering the interest rate would have a bad effect on the value of the Won, the Bank of Korea probably felt it had no choice given the overall economic situation.

There is some evidence that the exchange rate tends to follow the stock market, if the stock market is the first to show a significant decline. (Dimitrova, 2005) Simple observation of the performance of stock markets worldwide and in South Korea in particular seems to confirm this; the KOSPI has declined 40% through 2008, while the Won has lost 30% of its value. (International Herald Tribune, 7 November 2008) The continuing decline of the stock markets, then, is another reason why the exchange rate prediction was so far off the mark. The stimulus measures that have been taken by the Bank of Korea have not yet had a positive effect on the market, although some measures, like the $30 billion currency swap agreement with the U.S. seems to have slowed the decline of the Won. (Korea Times, 30 October 2008)

In conclusion, past performance and the opinions from financial experts and foreign-currency market observers have proved to be poor indicators for making a prediction about a future currency exchange rate, and this exercise, if repeated, would not use them. Along with observing the general direction of the stock markets, past exchange rate performance can provide for a prediction in only the most superficial sense, that is, whether the currency will advance or decline. Rapidly changing market conditions and reactionary measures on the part of central banks make accurate prediction of future rates in the current economic climate very difficult if not impossible.

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