

## CURRENCIES: KOREAN WON

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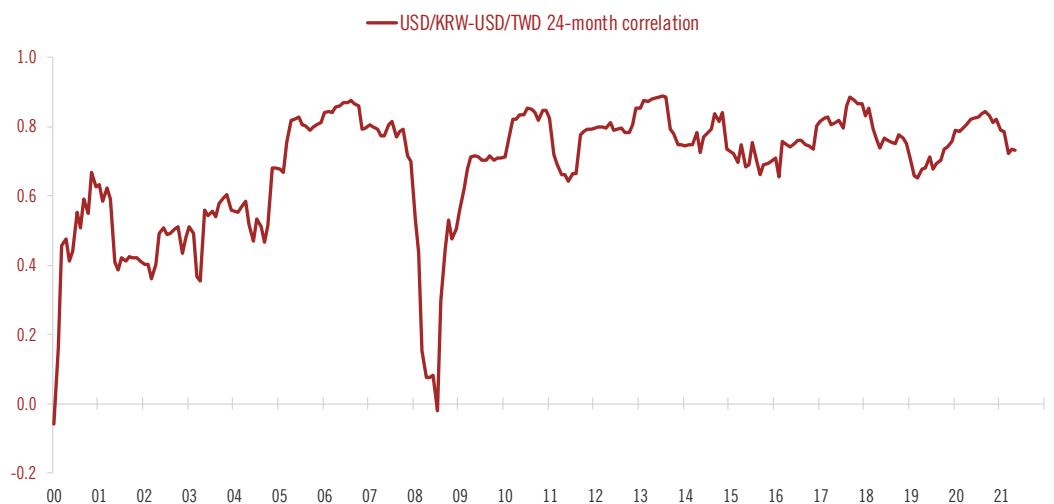
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## SUMMARY

- Like the Taiwanese dollar, the Korean won's exposure to the improving global economic cycle, its high-tech equipment exports and inherently defensive characteristics all make it attractive.
- However, the won may underperform the Taiwanese dollar because the shortage of computer chips may weigh on Korea's more diversified exports and because of less favourable balance-of-payments dynamics.
- Our projections for the USD/KRW rate KRW1,120 in three months, KRW1,100 in six months and KRW1,080 in 12 months.

CHART 1: CORRELATION BETWEEN USD/KRW AND USD/TWD



Source: PWM - AA&amp;MR, Refinitiv, 11 May 2021

## Similarities with the Taiwanese dollar

The Korean won is a low-yielding currency, highly sensitive to the global economic cycle. It shares many similarities with the Taiwanese dollar (see Flash note entitled 'Taiwanese dollar – Go with the flow', dated 10 May 2021): they are both supported by large trade balance surpluses, their economies are highly reliant on exports (with a specialisation in high-tech electronic equipment) and fiscal discipline in both economies is particularly strict. The correlation between the Korean won and the Taiwanese dollar (both expressed relative to the US dollar and over rolling 24-month periods) has been around 0.8 since 2010 (see chart 1).

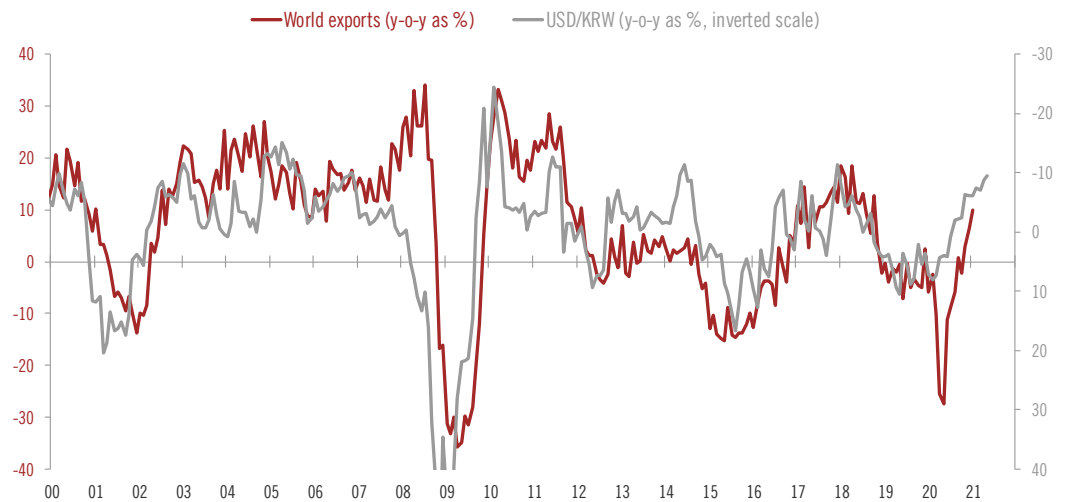
That said, the Korean economy is more mature (as can be seen by lower underlying growth) and it has a more highly developed financial market and diversified industrial sector. The Korean won is also perceived as somewhat overvalued, whereas the Taiwanese dollar looks at best as being fairly valued.

We think that the Korean won should perform well in the months ahead given the high global demand for computer chips, although we think it could underperform the

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Taiwanese dollar, given that Korean exports are more diversified. Indeed, chip shortages could also hurt Korean car production and exports. The Taiwanese dollar could perform better than the won if Taiwanese equities continue to outperform their Korean peers.

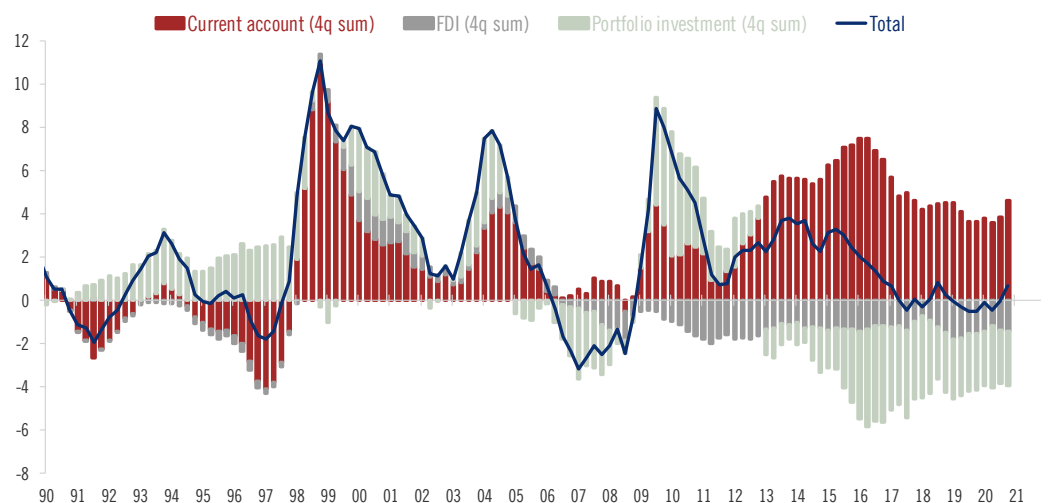
CHART 2: WORLD EXPORTS VS. USD/KRW



Source: PWM - AA&MR, Refinitiv, 11 May 2021

It is also worth noting that as well as accumulating foreign-currency reserves, Korea ‘recycles’ its current-account surplus through a mixture of foreign direct investment (FDI) and portfolio investment outflows. In Taiwan, portfolio investment outflows and FX reserve accumulation alone are the mechanisms employed, with dependence on FDI much less of a factor. In addition, as mentioned in our previous Flash Note, pressure from the US Treasury may reduce the Taiwanese central bank’s propensity to intervene to keep the value of the Taiwanese dollar low. Overall, balance of payments dynamics look less favourable to the won than the Taiwanese dollar.

CHART 3: KOREA CURRENT ACCOUNT, FDI AND PORTFOLIO INVESTMENT (AS % OF GDP)



Source: PWM - AA&MR, Refinitiv, 11 May 2021

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We acknowledge that the Bank of Korea is likely to raise rates before the Central Bank of Taiwan. Indeed, while we think that a rate hike is a 2022 story in Korea, the recent rise in core inflation and the strong economic momentum may lead to an earlier rate hike. However, rate differentials are not a key driver for the Korean won.

To sum up, our medium-term scenario of a weaker US dollar and gradual reopening of economies should provide a supportive environment for the Korean won. Our projections for the USD/KRW rate are KRW1,120 on a three-month horizon, KRW1,100 on a six-month horizon and KRW1,080 on a 12-month horizon.

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