KRW Update

October 2021

Further won weakness to be limited by central bank and current account

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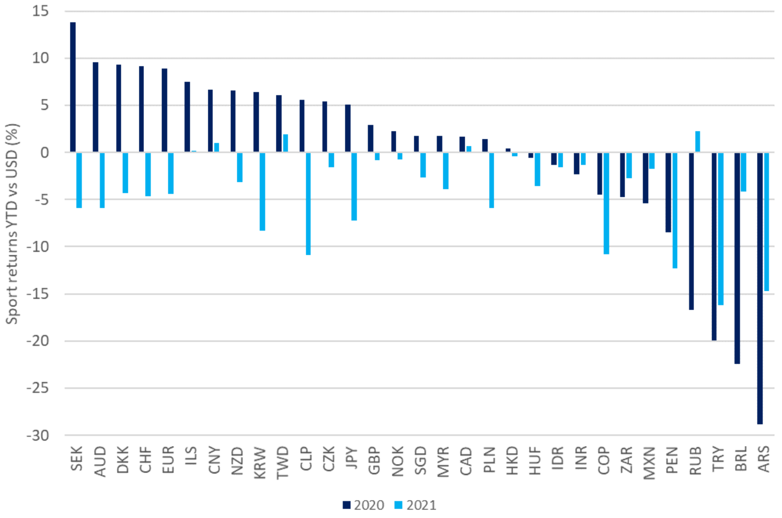
After ending 2020 on a relatively strong footing due to an effective Covid-19 containment policy and therefore limited economic damage from the pandemic, the Korean won now sits as one of the worst performing expanded majors' year-to-date. A combination of slowing semiconductor exports, higher yields in the DM space, and a resurgence of Covid-19 weighing on private consumption both domestically and in major trading partners, have all contributed to the unwind in aggressive USDKRW short positioning this year. While a backdrop of slowing Chinese and global growth, along with rising DM bond yields due to inflation concerns, suggests the won's depreciation is likely to extend, other domestic and external factors that suggest further KRW depreciation will be limited. These include a rapid vaccination programme and a hawkish Bank of Korea. Additionally, should global growth conditions improve, these domestic and external factors are likely to evolve into tailwinds for a retracement in recent USDKRW price action. For these reasons, and our view that the macro backdrop will improve in 2022, our forecasts envisage a return to the 1140 level in USDKRW over the 12-month period.

Korean won flips from one of the best performing currencies in 2020 to one of the worst performing in 2021

**2021 returns are measured YTD as of 28/09/2021*



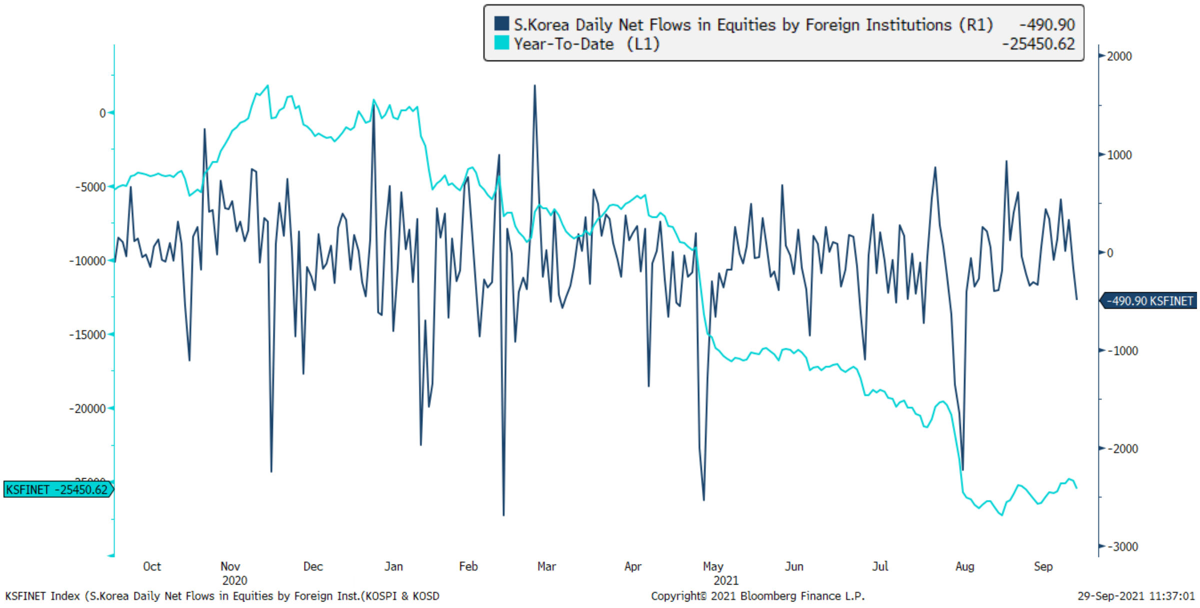
Domestically, a rapid vaccination campaign and a hawkish Bank of Korea should help mitigate pressure on the won. The vaccination campaign, coupled with pandemic fatigue and recent fiscal stimulus measures, has meant that economic confidence indices remain well supported despite the latest wave of Covid-19. In addition, sequential growth data remains elevated.

With the economy on track to reach the Bank of Korea's 4% growth projection in 2021 and inflation remaining sticky above the 2% target, the BoK is likely to continue hiking rates by 25bps at November's meeting to counter financial imbalances – a primary concern among policymakers given recent housing market developments and the build-up in debt. While the additional rate hike at November's meeting is already priced in by fixed income markets, any suggestion by the BoK that the hiking cycle is set to continue at a gradual pace will be received as a hawkish development by markets, especially as the last rate hike was met with one dissenting policymaker.

> Given the more conducive domestic economic backdrop due to higher vaccination rates, the slowdown in global growth already being priced in, and the reduction in DRAM prices stabilising, **equity outflows are likely to slowdown.**

This comes after sustained foreign outflows, with equity analysts pinning the foreign selling to two chip manufacturers. The two stocks are estimated to account for up to 80% of the YTD outflows. Coupled with a strong current account and a potential pick-up in sequential EM growth, these external factors should provide a modicum of support for the Korean won despite the broadly unfavourable risk backdrop.

Equity outflows are set to stabilise as the reduction in DRAM prices moderates and lower global growth expectations are priced in



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MONEX

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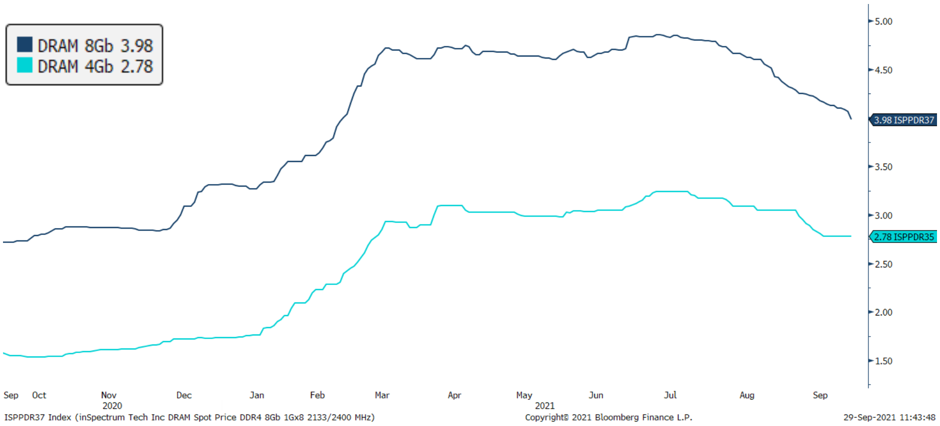

With supportive external and domestic factors, we expect USDKRW to consolidate around the 1180 handle amid the current risk backdrop. Heading into 2021, we expect global macro conditions to improve somewhat as supply-chain disruptions ease, vaccination rates improve and Covid caution reduces in major economies. However, gains in KRW are expected to be limited, largely due to tighter fiscal and monetary policy globally. This lower, but more sustainable growth trajectory, should still remain conducive for South Korea's current account. On the rates front, earlier lift-off by the BoK and a sustained hiking cycle throughout 2022 expected should mean KRW is relatively well shielded from the rise in front-end DM rates over the forecast horizon.

> "Risks to our **USDKRW** forecasts are largely tilted to the upside."

Slower Chinese growth and a more disruptive restructuring of its real estate market poses downside risks to South Korea's current account. Additionally, a disruptive restructuring in China is likely to weigh on risk sentiment broadly, further weighing on EM FX performance vs USD. While more aggressive Fed normalisation also poses a risk from a rates perspective, we think the BoK's current stance on policy normalisation should effectively shield the won.

March's 2022 election also scans as a risk to the current economic trajectory, while the departure of Chairman Lee Ju-yeol and Lim Jiwon from the Bank of Korea poses a risk that the current monetary policy stance may be altered.

Monex's October forecasts

	1-month *31st Oct 2021*	3-month *31st Dec 2021*	6-month *31st Mar 2022*	12-month *31st Sept 2022*
USDKRW	1180	1170	1155	1140

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