

Outlook for the KRW

Overview

The Korean won has appreciated against the US dollar and Japanese yen far more than any other Asian regional currency over the past few quarters. The fundamental factors driving this appreciation include an improving economic outlook and, in conjunction with the recovery, rising interest rates. However, our expectation is that the won will now pause, and will not strengthen significantly from current levels – at least, not until the yen starts to strengthen against the US dollar. This is anticipated in the second half of this year.

ANZ currency forecasts

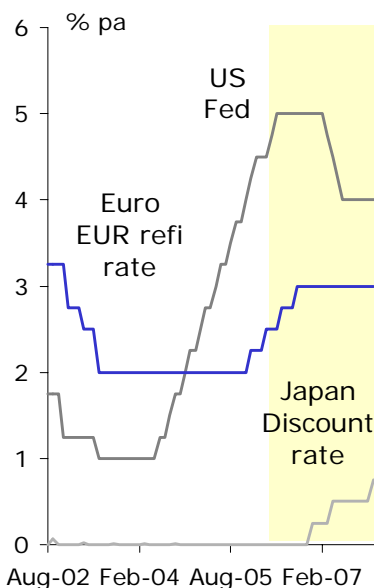
	Mar 2006	Jun 2006	Sept 2006	Dec 2006
USD/KRW	965	970	960	955
USD/JPY	119	118	112	108
AUD/KRW	733	718	682	669
AUD/JPY	90.4	87.3	79.5	75.6

A changing global rate environment

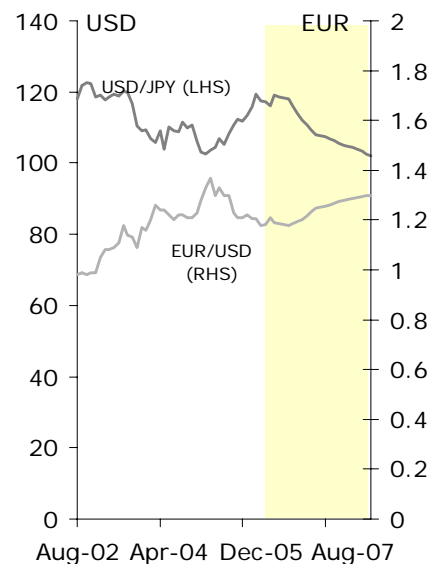
The rapidly changing global interest rate environment has become a primary driver of exchange rates, and is expected to remain so in the coming months. The US dollar strengthened over the course of 2005 against the major currencies, following progressive rate hikes by the US Federal Reserve. In 2006, we expect the Fed to stop raising rates in the first half of the year, while benchmark rates are anticipated to increase in the Euro zone and in Japan. The rotation of monetary policy tightening will flow through to exchange rates, with market consensus and ANZ forecasts both calling for USD weakening in the second half of the year.

Changing interest rate differentials

Policy rates – US, EUR, JPY



Exchange rates



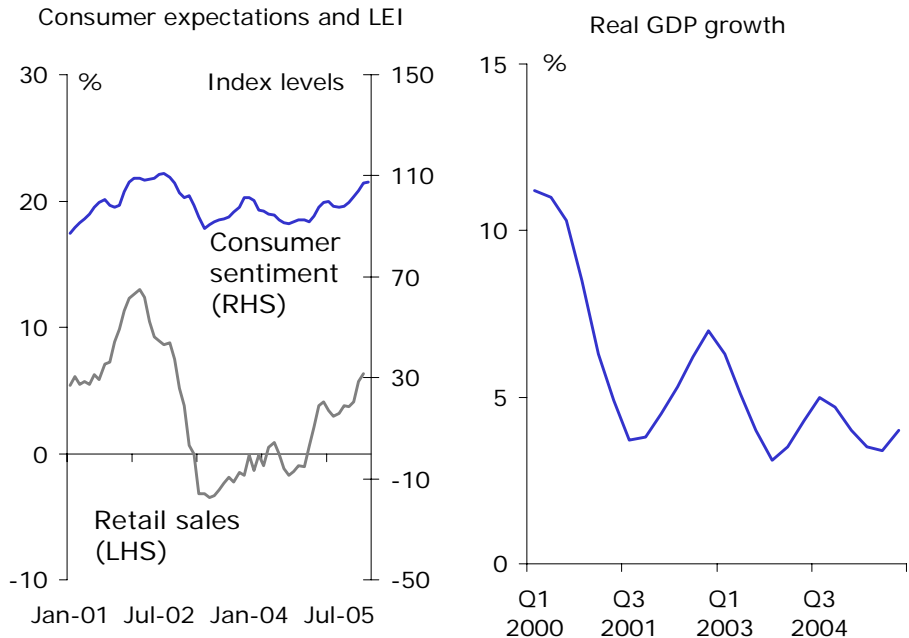
Source: Datastream, Bloomberg, Economics@ANZ

Authors:

Amy Auster
 Head of International Economics
 Phone +61 3 9273 5417
 Email auster@anz.com

The KRW is an early harbinger of this trend. The economy began to recover from a sharp slowdown in domestic demand mid-way through 2005. In October 2005, the central bank raised its target overnight call rate from a year-long record low of 3.25%. The stated objective is to remove the monetary policy accommodation that had been put into place to help consumer demand recover from a negative shock created by a heavy buildup in credit card debt.

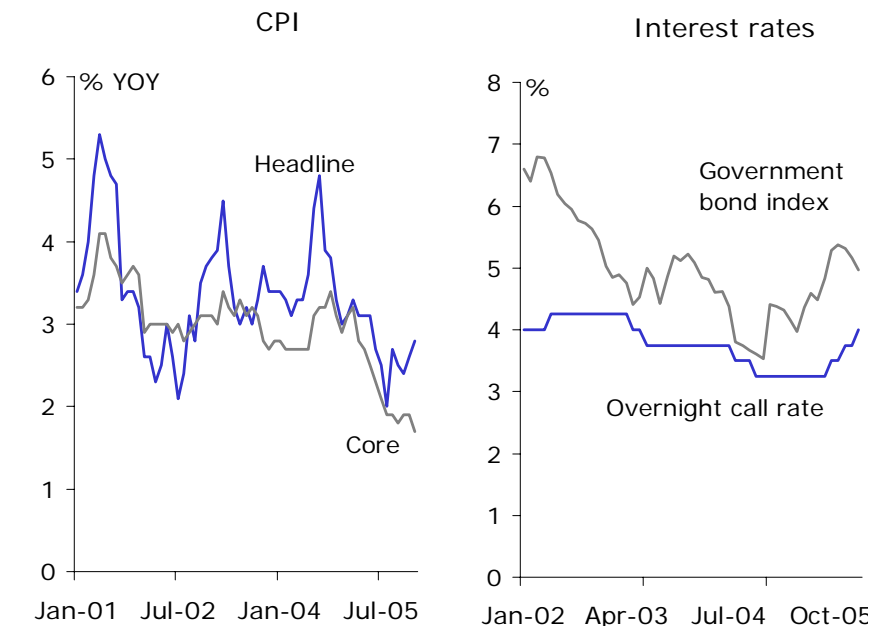
Korean economic recovery continues



Source: Datastream, Economics@ANZ

Although inflation has ticked upward with the economic recovery, price pressures remain muted. With the central bank now having reached a policy rate of 4%, we believe the policy stance has become neutral. Longer-term yields have also responded, rising from a low of 3.8% on the Government Bond Index to around 5% at present. Rates should not need to rise from here unless latent price pressures become more apparent.

Interest rates normalise

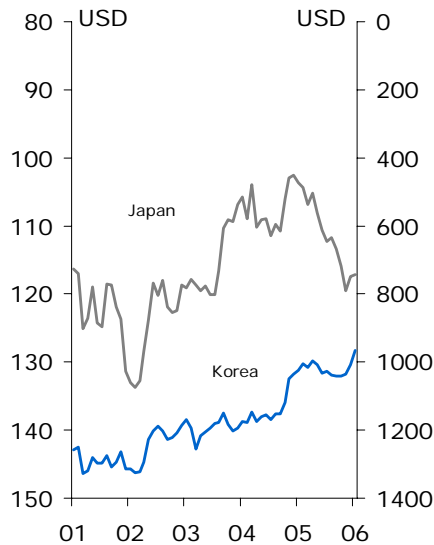


Source: Datastream, Economics@ANZ

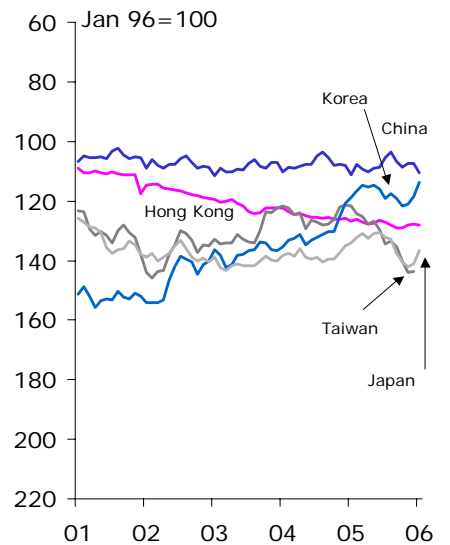
Given our expectations that the Bank of Korea has stopped raising interest rates, there seems to be little reason to anticipate the won will rally further. The won has already appreciated significantly on a nominal and real exchange rate basis over the course of the past year, particularly relative to the yen.

Currency has already rallied

Nominal exchange rate vs USD



Real exchange rate vs USD



On the righthand chart an upward movement indicates an appreciation of the 'foreign' currency against the 'home' currency (USD or JPY). Any implied % shift is measured as a proportion of the home currency.
Sources: Datastream, Economics@ANZ

Our expectation is that the Korean won will remain in a trading range of USD/KRW 955-970 for much of this year, possibly strengthening toward the end of the year if the yen rallies as we anticipate will occur.

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