

## The won readies for a run

The won has been strengthening against the US dollar ever since the latter peaked in 2002. Indeed it may surprise readers to learn that the won, now at 902 per dollar, has recouped virtually all its losses suffered since the 1997/98 Asian financial crisis.

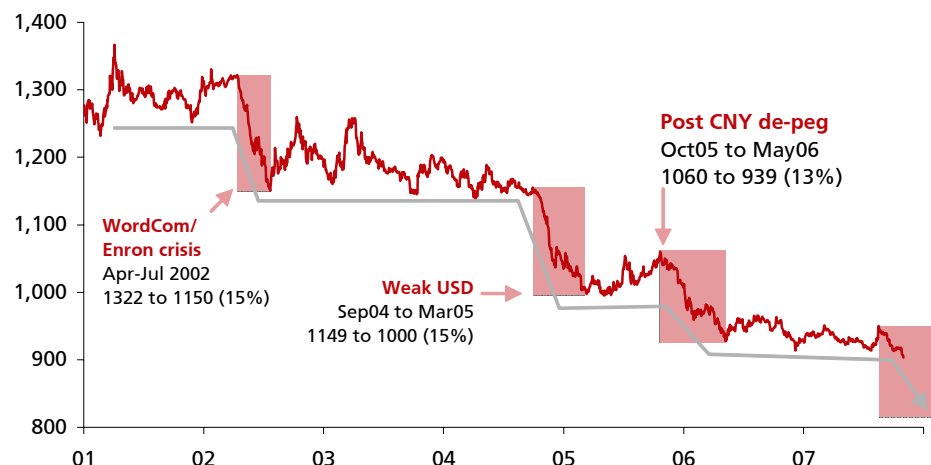
Unlike some of its Asian peers, the won tends not to appreciate steadily. Rather, it has a record of strong moves followed by periods of consolidation. As one would expect, the appreciation phases have typically occurred when dollar sentiment is weak.

Since 2002, the won's gains have occurred mainly during three key periods:

- The first episode occurred in 2Q02, when investors lost confidence in the dollar following corporate malfeasance that pummelled US equities. The won appreciated by 15% against dollar from Apr02 to Jul02. Note: In terms of sentiment, that experience is not dissimilar to today's US subprime/ credit woes;
- The second episode came in 4Q04 when the US dollar was dumped on fears of global imbalance. The won appreciated by 15% from Sep04 to Mar05. Note: Last month's G7 meeting saw the issue of global imbalances returned to the front burner;
- The third episode began in 4Q05 after the Chinese yuan was de-pegged from the dollar in late Jul05. The period coincided with a sharp rise in global electronics demand ahead of the World Cup in 2006 (think Samsung flat screen TVs). The won appreciated by 13% between Oct05 and May06. Note: Today, the G7 has singled out China for faster currency appreciation and the 2008 Olympics is only ten months away.

Plainly, in key ways, the past looks a lot like the present.

### USD/KRW has a track record of collapsing during periods of weak USD



Sources: Reuters, DBS Research

The won appreciates whenever USD sentiment is weak

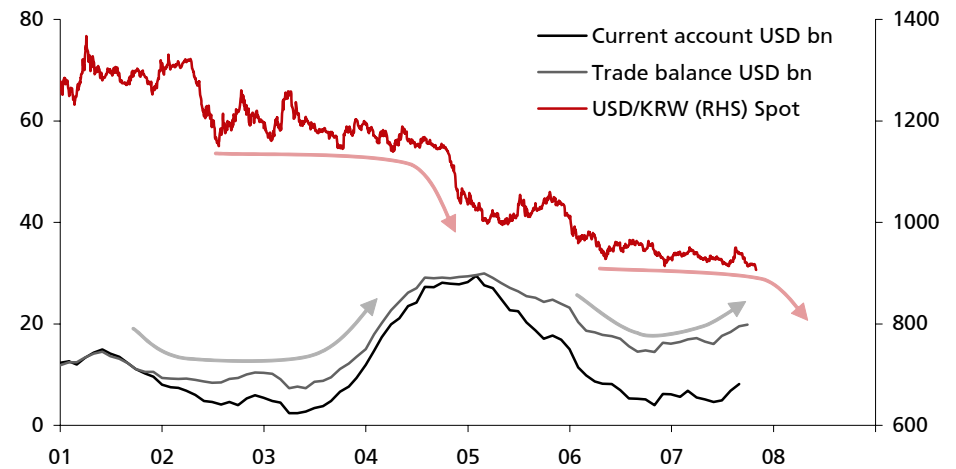
But besides the weak US dollar, other factors such as external surpluses, equity market performance and interest rates all point to faster won appreciation ahead.

**Trade surpluses are rising again**

In 2004, the stronger won was preceded by rising surpluses in Korea’s trade and current accounts – surpluses which are growing again today. And compared to 2004, Korea’s fundamentals today are stronger. GDP growth, for example, is accelerating, not slowing, with the service sector improving from a higher base.

**Rising trade & current a/c surpluses = won strength**

The won appreciates once rising trade and current account surpluses become evident



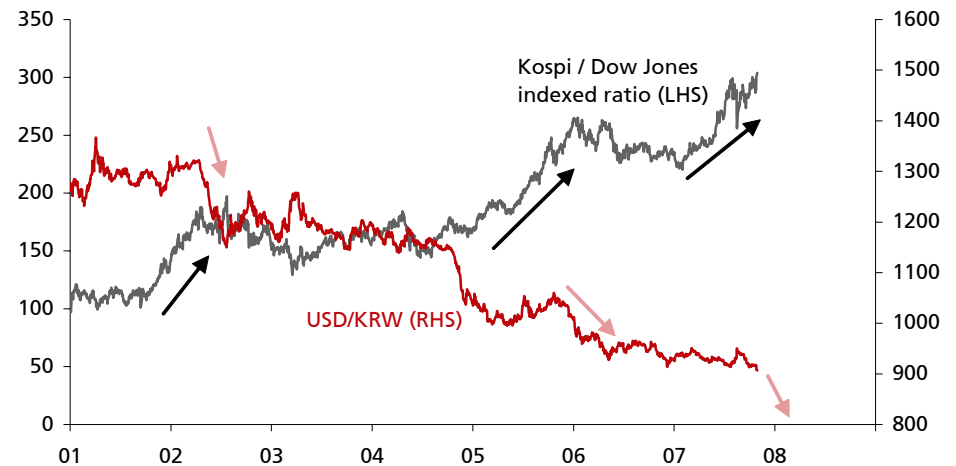
Sources: CEIC, DBS Research

**Korea’s stock market is outperforming the US**

Both the KOSPI and the Dow Jones have hit record highs this year, but the KOSPI has outperformed the Dow by a factor of four (both in local cy terms). Historically, whenever Korean equities outperform the US, the stage is set for the won to play catch-up to Korea’s stronger fundamentals vis-a-vis the US. We see no reason why things should be different this time around.

**KRW gains come after Korean stocks outperform US**

The won appreciates after Korean stocks outperform the US



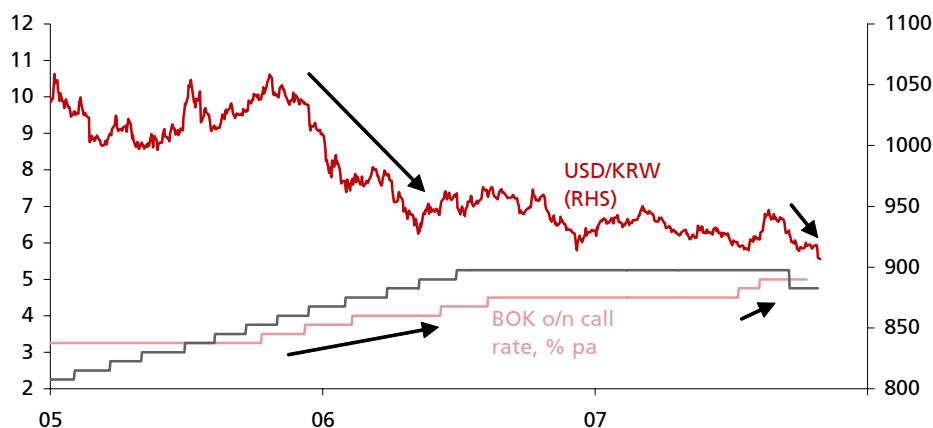
Sources: Reuters, DBS Research

### Interest rates favor the won

Last but not least, policy interest rates in Korea are finally higher than in the US. The Bank of Korea lifted its overnight call rate in July and August by a total 50bps to 5.00% to pre-empt inflation. Meanwhile, the Fed cut rates by 50bps to 4.75% in September to cushion the US economy and its financial sector from the US subprime/credit crisis. Another 25bps Fed cut is expected today.

### Divergent Korea-US monetary paths should benefit the KRW

The won appreciates when BOK policy is more hawkish than Fed policy



Sources: Bloomberg, DBS Research

### Bottom line – we have upgraded our KRW outlook

Market	Oct 31	4Q07	1Q08	2Q08	3Q08	4Q08
DBS New	902	890	880	870	860	850
DBS Old	--	920	910	900	890	880
NDF fwd	--	900	898	897	896	896
Consensus	--	910	910	908	902	900

The won has scope to appreciate 10% from its low of 950 in Aug, maybe more

After considering the above factors, we have decided to upgrade our forecast for the won. Plainly, we reckon consensus will be proven wrong in its expectations that USD/KRW will stay above the psychological 900 level for the next 14 months.

Taking a conservative stance, we estimate the present period of won appreciation (which began with the won at 950 on Aug 17) could amount to 10% or more, still less than the 13-15% gains seen in previous episodes. This would put the won at around 850 per dollar by end-08.

Should the won perform as in previous episodes and appreciate by 15%, a level of 825 per dollar would be implied.

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