Running Head: Currency Rate Prediction

Predicting the Spot Rate of South Korean Won to U.S. Dollar Currency Exchange

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Primary Information Source & Definitions

In order to predict the spot exchange rate for South Korean Won to U.S. Dollars, this report will rely on the interbank exchange rates published online by OANDA.com, a well-known source which is often used by news agencies and others for consistent currency exchange rate information. The U.S. Dollar will be used as the base currency, so that the rates expressed in this report will be in the form $1 = some number *n* South Korean Won (KRW).

Methodology

The period of time between 26 September and 21 November 2008 is 57 days, so the first factor that will be considered in attempting to predict the spot rate on the latter date will be the history of the rate over a similar time period preceding 26 September 2008, or in other words, from 1 August through 25 September 2008. The second set of data that will be examined will be the rates for 26 September and 21 November for the years 2000 through 2007. The patterns established by these data sets will then be compared to predictions of trends published by various financial experts. All these sources of information will, it is hoped, permit the accurate prediction of the $=KRW spot rate on 21 November 2008.

Past Performance

Table 1 shows that the Won has steadily weakened over the period 1 August to 26 September 2008. Beginning with spot rate of $1 = 1,012.66 KRW on 1 August, the Won declined to $1 = 1,159.42 KRW on 26 September:

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Table 1: 1 August – 26 September Spot Rate

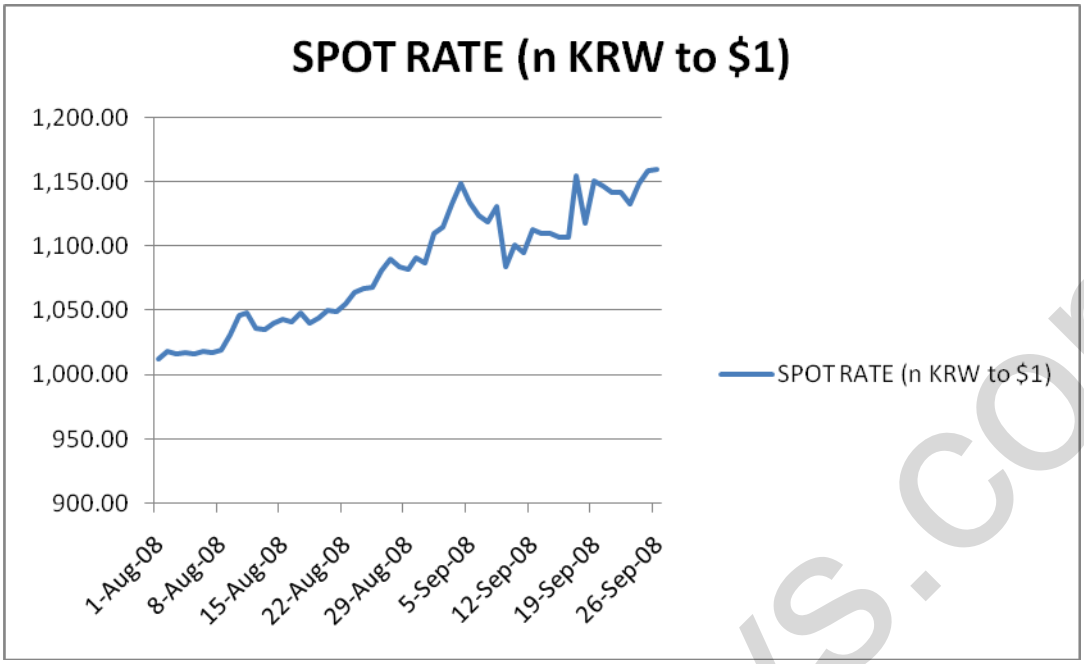
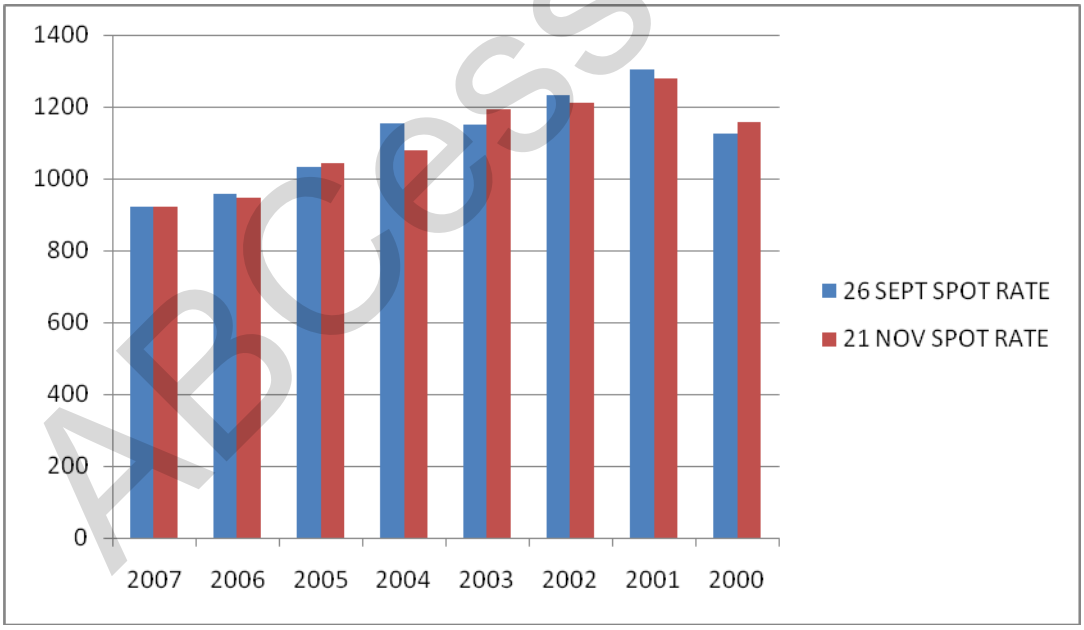


Table 2 shows the difference between the 26 September and 21 November spot rates for each of the past eight years:



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Overall, the average difference between the 26 September and 21 November spot rates over the past eight years is 0.49%, with very small differences in the two rates in each of the past three years.

Expert Predictions

A poll of 12 major financial firms published on 5 September by Forbes revealed an expectation of a stronger Won by year's end, with an average spot rate of 1,080. (Thomson Financial News/Forbes.com, 2008) The Financial Forecast Center, in numbers updated on its website (www.forecasts.org) on 10 September, gives an opposing picture, pegging the Won at 1,144 in November. (FFC, 2008) And finally, the Forex Trading Signals website, another internet-based foreign exchange resource, on 24 September provided a 4th-quarter 2008 prediction for the Won of 1,015, even more optimistic than the consensus published by Forbes. (forex-trading-signals.net, 2008) These varying predictions illustrate, if nothing else, the difficulty in accurately forecasting a future rate for a volatile currency like the Won.

There is one particular reason given for the experts' forecasts for the Won. The recent weakness of the currency has caused the South Korean government to aggressively sell Dollars, which has the immediate effect of increasing supply of the foreign currency, thereby lowering its price in relation to the Won. (FFC, 2008) Another related factor, although it is uncertain if it will indeed occur, is the possibility that the Bank of Korea may again raise interest rates, which it last did on 7 August 2008. (Lewis, 2008)

The relationship of interest rates to the currency exchange rate is indirect, but still significant. As the currency weakens, inflation increases, and controlling inflation is usually the main reason for adjusting interest rates. A higher interest rate curbs spending, which lowers

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inflated prices; as a consequence, the currency strengthens. Although the expectation of the respondents in the Forbes poll is that the Bank of Korea will hold the interest rate steady for the remainder of the year, there is still the possibility that there will be another increase. This would have the effect of heading off further inflation, and would also send a signal to currency traders that the Won is expected to strengthen, discouraging them from selling off the currency. In addition, keeping economic circumstances under control in Korea, which another interest rate hike might achieve, helps to prevent the loss of foreign capital, which also weakens the Won. (FFC, 2008)

Final Prediction & Rationale

The Won has undergone a steadily weakening trend despite one increase in interest rates by the Bank of Korea, and has in fact weakened considerably further since 26 September; the spot rate on 30 September was $1 = 1,186.94 KRW. With the continuously worsening economic news from the U.S. and the risk that poses for foreign investment in Korea, the weakening Won may inspire the Bank of Korea to again raise interest rates, despite the opinions of the experts polled by Forbes. Keeping in mind that the previous raising of the interest rate did not appreciably slow or reverse the Won's decline, it would be expected that continued aggressive Dollar selling would also be needed to exercise firm control over the Won rate. If that happens, the spot rate for the Won will more closely resemble the pattern exhibited over the past several years, with a relatively minor difference (an average of 0.49% higher) between the September and November rates. The prognosis now, however, is that the Won will be weaker rather than stronger on 21 November than on 26 September, probably by about 2.39%, its average decline in

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2000, 2003, and 2005, the three years of the 2000 through 2007 in which the spot rate increased (see Appendix). Applying that factor to the 26 September spot rate of 1,159.42 yields:

1,159.42 ÷ 1.0239 = **1187.13 KRW = $1**

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References

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Appendix: Exchange Rate Data (source: OANDA.com)

DATE	SPOT RATE (*n* KRW to $1)
26-Sep-08	**1,159.42**
25-Sep-08	1,158.35
24-Sep-08	1,148.11
23-Sep-08	1,132.37
22-Sep-08	1,141.81
21-Sep-08	1,141.29
20-Sep-08	1,146.26
19-Sep-08	1,150.62
18-Sep-08	1,117.94
17-Sep-08	1,154.47
16-Sep-08	1,107.17
15-Sep-08	1,106.93
14-Sep-08	1,110.12
13-Sep-08	1,109.51
12-Sep-08	1,112.59
11-Sep-08	1,094.93
10-Sep-08	1,101.32
9-Sep-08	1,084.48
8-Sep-08	1,130.33
7-Sep-08	1,119.07
6-Sep-08	1,123.72
5-Sep-08	1,133.53
4-Sep-08	1,148.90
3-Sep-08	1,132.25
2-Sep-08	1,114.70
1-Sep-08	1,109.39
31-Aug-08	1,087.07
30-Aug-08	1,090.99
29-Aug-08	1,082.02
28-Aug-08	1,084.36
27-Aug-08	1,089.92
26-Aug-08	1,081.20
25-Aug-08	1,067.92
24-Aug-08	1,067.69
23-Aug-08	1,063.83
22-Aug-08	1,055.19
21-Aug-08	1,049.76
20-Aug-08	1,050.42
19-Aug-08	1,044.71
18-Aug-08	1,040.58
17-Aug-08	1,048.33
16-Aug-08	1,041.45
15-Aug-08	1,043.19
14-Aug-08	1,040.26
13-Aug-08	1,035.73
12-Aug-08	1,036.27
11-Aug-08	1,048.66
10-Aug-08	1,046.35
9-Aug-08	1,031.78
8-Aug-08	1,019.37
7-Aug-08	1,017.81
6-Aug-08	1,018.50
5-Aug-08	1,016.80
4-Aug-08	1,017.20
3-Aug-08	1,017.10
2-Aug-08	1,018.40
1-Aug-08	1,012.66

YEAR	26 SEPT SPOT RATE	21 NOV SPOT RATE
2007	920.92	919.77
2006	958.41	948.05
2005	1,031.70	1,043.80
2004	1,152.40	1,077.00
2003	1,151.60	1,191.30
2002	1,232.00	1,211.80
2001	1,305.00	1,280.00
2000	1,126.00	1,157.00

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