Won to Watch

• The KRW is under pressure on a number of fronts
• China has held the key to the KRW's fortunes
• But the focus has shifted to domestic policy settings

On Friday, the Government Pension Fund of Norway announced plans to streamline its fixed income portfolio by cutting its exposure to EM bonds issued by 10 nations.

South Korea, where the Fund holds $6.3bn of sovereign and corporate debt, will be the hardest hit, and the decision left the KRW vying with the election-focused INR as yesterday’s worst performer in Asia.

On the face of it, that dividend repatriation may have contributed to its slide offers the KRW some hope of a reprieve; but the Fund's announcement only serves to complement existing pressures that have not only made the KRW Asia’s worst performer year-to-date, but that have yielded 2.6% losses despite modest gains for other select Asian currencies.

Uncertainty surrounding China’s economic outlook and its relations with the US has been a large factor behind this underperformance. Five of the top 10 daily moves in the KRW this year have been instigated by China-related news (North Korea, the FOMC and now Norway’s Fund make up the rest).

Newswatch

1. US proposes list of tariffs on EU produce in retaliation for EU Airbus subsidies

2. EU Presidency calls for UK explanation for Brexit extension, noting that the EU "cannot afford to discuss the same issue on Brexit every
Although the KRW’s path has been circuitous since late January, its 3% losses to the USD in the interim began at the end of January amid the growing realization that the US’ March 2 trade deal deadline with China would not be met.

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With only few exceptions, cross-correlations in USD-Asia have been historically strong, and hence, that a 91% correlation between USD/CNH and USD/KRW (since the start of last year) began to break down at the start of March is not to be ignored.

In view of its return to impressive levels of stimulus, China constitutes a double-edged sword for its trading partners and their respective currencies; but the collapse in this relationship perhaps hints at concerns above and beyond those that can be remedied by trade. Damaging uncertainty has taken its toll.

Rising global growth uncertainties – recognized by the Bank of Korea in January - are anathema to a country that has become overly dependent not only upon trade but upon selective exports to boot.

Factory output has slumped to a two-year low amid four months of falling export volumes fueled by sliding semiconductor shipments. DHL Global Trade Barometer, an early indicator of global trade developments, points to a continued deceleration in growth.

Little wonder that the yield on the benchmark three-year bond is struggling to rebound from its late March plunge
Finance Minister Hong Nam-ki is therefore planning on fiscal stimulus – albeit with a somewhat smaller-scaled package than that proposed by the IMF. But the market may be coming to the view that government hopes for 2.6% growth this year will also require a shift in the BoK’s policy guidance.

BoK Governor Lee Ju-yeol told reporters last week that “the situation doesn’t warrant reviewing an easing in policy interest rates now,” but the market would be forgiven for having its doubts. Slow growth will only compound the pressures that have seen inflation collapse – from 2% last October to just 0.4% at present – the second lowest in the OECD.

Little wonder, therefore, that the yield on the benchmark three-year bond has struggled to rebound from its late-March plunge – the bond yield’s gyrations being something that USD/KRW has paid closer attention to of late, given a rolling one-month 65% correlation.

Please direct questions or comments to:

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