

Navigating the KRW Depreciation: Structural Resilience vs. Historical Trauma



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Since early 2025, the Korean won (KRW) has faced persistent downward pressure, exhibiting a pronounced weakness against major currencies, with the notable exception of the Japanese yen. For the first time in history, the annual average KRW/USD exchange rate has breached the 1,400 level. This surpasses the average rates seen during the Asian Financial Crisis (1,395 won in 1998) and the Global Financial Crisis (1,276 won in 2009). Consequently, speculative concerns regarding a potential currency crisis have emerged within domestic media. Having experienced the trauma of the 1997 Asian Financial Crisis and the 2008 Global Financial Crisis, South Korea remains sensitive to such volatility. This report compares the current situation with these past crises to assess the risk level and delineate policy imperatives for FX market stability.

While these three periods share the commonality of rapid depreciation, their historical troughs diverge significantly: 1,962 won in December 1997, 1,570 won in March 2009, and 1,484 won in April 2025. Analysis of Nominal and Real Effective Exchange Rates (NEER/REER), which account for

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trade-weighted inflation and partner currency values, corroborates this divergence.

However, the current situation differs fundamentally from the past in two key areas. Firstly, the nation's external soundness has improved significantly. In stark contrast to previous crises—which were marred by current account deficits, surging short-term debt ratios, and precarious international reserve levels—the macroeconomic indicators for 2025 underscore a robust state of health. The current account achieved a record surplus of \$123.1 billion, while the short-term debt ratio stands at a historically low 38.3% relative to reserves. Furthermore, international reserves exceed \$420 billion, ranking Korea 9th globally in terms of FX liquidity buffers.

Secondly, there has been a definitive structural shift toward a sustained surplus in the Net International Investment Position (NIIP). Korea's maturation into a net creditor nation represents a pivotal transformation; the NIIP has expanded steadily since turning positive in 2014, reaching \$1,056.2 billion by Q3 2025. Even excluding official reserve assets, the private sector maintains a massive NIIP surplus of \$634.2 billion, functioning as a de facto FX safety net. This stands in sharp contrast to past crises where Korea was a net debtor and FX importer. As noted by Jeong et al. (2023), in net creditor nations, resident capital retrenchment—the repatriation of overseas assets during non-resident capital "stops" (outflows)—acts as a powerful buffer against the deterioration of external soundness.

Notwithstanding the Korean won's current weakness, the probability of a systemic FX crisis remains exceptionally low. Korea's 5-year CDS premiums (21.8bp) and Foreign Exchange Stabilization Bond spreads (23.0bp) are at historical lows, with the CDS premium notably tighter than that of Japan (26bp). FX liquidity indicators, including the 3-month swap rate and 3-year CRS rate, remain favorable, indicating stable market depth and limited arbitrage-driven stress.

What then accounts for the Korean won's depreciation? The primary catalyst appears to be idiosyncratic domestic factors rather than broad global dollar trends. Paradoxically, the accelerated expansion of overseas securities investments by residents—the very engine driving the NIIP surplus—stands as a primary driver of the won's decline. The share of foreign assets in total financial transactions, measured on a Balance of Payments (BoP) basis, has climbed from approximately 40% pre-2010 to nearly 70% recently, signaling that the impetus for capital flows has pivoted from non-residents to domestic institutional investors since 2013.

Furthermore, speculative herding among domestic FX market participants is intensifying the won's depreciation. The \$350 billion total investment commitment to the U.S. under recent tariff negotiations—specifically the \$200 billion in cash outflows capped at \$20 billion annually—has

solidified market expectations of a structural dollar-demand surplus.

This surge in resident outbound investment and herding behavior are driven by a complex interplay of domestic and external factors. Domestically, the aging population's rising savings, coupled with low growth, low interest rates, and the "Korea discount," have incentivized capital outflows. These pressures are further compounded by U.S. protectionism, the persistence of "America First" policies, and the superior growth and corporate performance of the U.S. economy in the AI era.

Since the current depreciation is rooted in these internal structural dynamics and resident capital flows, policy responses must prioritize domestic market stabilization. In the near term, authorities should focus on dampening excessive volatility and curbing one-sided speculative bets by reinforcing financial safety nets. To ensure exchange rate stability, authorities must expand bilateral currency swaps with major economies like the U.S., Eurozone, and U.K., while deepening coordination with key partners like the U.S. and Japan. Given the National Pension Service's (NPS) systemic impact on the FX market, utilizing the Fed's FIMA Repo Facility through enhanced BOK-NPS coordination is essential. Additionally, monetary policy must account for the negative externalities of a high exchange rate—such as imported inflation and external debt burdens—while authorities strengthen flexible FX macroprudential measures and repatriation incentives to balance market supply and demand.

Over the mid-to-long term, Korea must maximize the strategic dividends of its expanding external assets. With domestic pension reserves expected to surge from \$1.64 trillion in 2025 to over \$3.57 trillion by 2040, outbound investment has become an inevitability given the limited depth of domestic capital markets. It is therefore imperative to establish a virtuous cycle where financial stability and financial internationalization serve as mutually reinforcing drivers of economic growth: expanding the Net International Investment Position (NIIP) will fortify financial market stability, which in turn facilitates advanced outbound financial internationalization. This progression will enhance primary income and financial service surpluses on a BoP basis, ensuring a structural current account surplus that further fuels NIIP expansion.

Ultimately, securing stable foreign capital inflows and encouraging the repatriation of resident funds requires a fundamental strengthening of the Korean economy. This necessitates persistent efforts to innovate financial market infrastructure, advance institutional frameworks, and cultivate sustainable long-term growth drivers. [KIEP](#)