EFFECTS OF LOW YEN ON THE KOREAN ECONOMY

Dollar's Appreciation against the Yen

The Japanese yen appreciated against the U.S. dollar early this year and reached an all-time high in the middle of April. The yen, however, slowly depreciated against the dollar during the April-July period. Abrupt depreciation of the yen occurred in August and the yen-dollar rate is likely to regress to the level shown in December 1994.

Because of a tacit agreement between the U.S. and Japan that any further rise of the yen would worsen the Japanese economy as well as the world economy, the U.S. and Japanese central banks collaborated to lower the value of the yen by purchasing dollars in the foreign exchange markets. Both Japanese efforts to curb the strong yen and interest rate differentials between the U.S. and Japan have stimulated the recent rise of the dollar's value. Moreover, brisk U.S. and sluggish Japanese stock markets as well helped boosting the dollar's value.

The Korean won has also depreciated against the dollar because of the strong dollar in the foreign exchange markets and the fall in the inflow of foreigners' stock investment fund. The Korean government changed the exchange rate policy from won's appreciation for stable price level to its depreciation for stable exports. However, it is likely that the dollar appreciates against the yen faster than it appreciates against the won so that the Korean economy may be negatively affected, especially in exports. It is obvious that Korean export competitiveness will be hampered by the yen's fall.

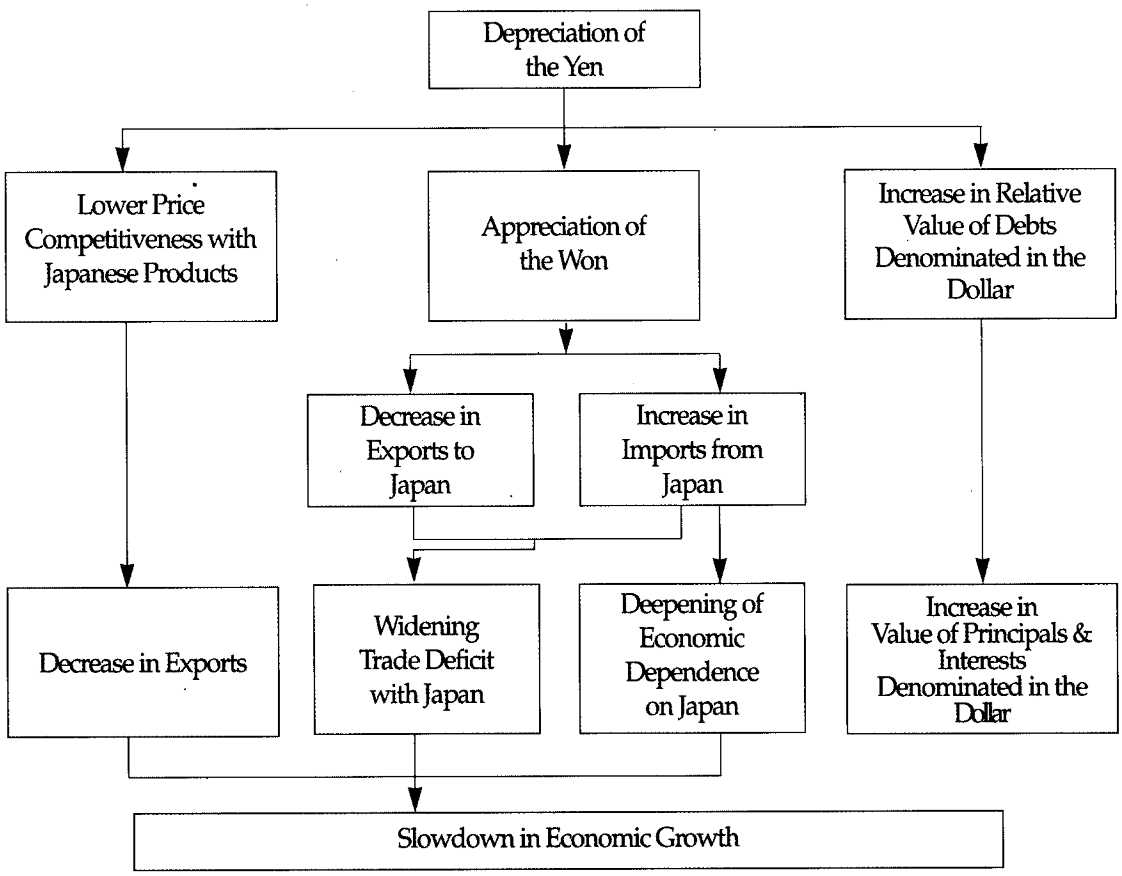
Slowdown in Economic Growth

Until recently the super strong yen has positively affected Korean exports of goods from the heavy and chemical industries, e.g., semiconductors, automobiles, steel, vessels and the Korean economy as well. However, the abrupt depreciation of the yen against the dollar would have an adverse impact on those industries and the Korean economy in about six months due to the enhanced international competitiveness of Japanese products. In addition, Korean trade deficit with Japan will increase because the yen's fall makes Japanese goods cheaper in Korea, leading to a large increase in imports from Japan.

According to the estimation results of Hyundai Research Institute (HRI), a change in the exchange rate from 90 to 100 yen per U.S. dollar will result in a 2 percent reduction in exports in the first year and a 2.2 percent annual losses for the next three years. In addition, the trade deficit will increase by 1.2 billion dollars in the first year and by 1.17 billion dollars in the second year and the economic growth rate will decline by 0.4 and 0.5 percent, respectively.

The worst-case scenario is that the yen's depreciation and the won's simultaneous appreciation will deal a crippling blow to the Korean economy. Fortunately, the current exchange rate trend shows that we may not be heading toward the worst-case scenario. If both the yen's depreciation by 11.1 percentage points, e.g., the yen-dollar rate from 90 to 100, and the won's simultaneous depreciation by 3.9 percentage points, e.g., the won-dollar rate from 760 to 790 take place, there will be no impact on the Korean economy according to the HRI's estimates.

Effects of Low Yen on the Korean Economy



Effects of Low Yen on Some Selected Variables

	1st Yr.	2nd Yr.	3rd Yr.	4th Yr.
GNP(%)	-0.4	-0.5	-0.4	-0.4
Exports(%)	-2.0	-2.2	-2.2	-2.3
Imports(%)	-1.0	-1.5	-1.8	-1.9
Trade Bal.($ Bil.)	-1.2	-1.17	-0.87	-0.7
CPI(%)	-0.1	-0.3	-0.5	-0.6

Note : Yen-Dollar rate (90→100) & Won-Dollar rate (760→790)
Simulation Results using the HRI Econometric Model of the Korean Economy and Industry

Some Heavy Industries May Suffer

By industry, the effects of the low yen on Korean exports depend on both the price competitiveness and its portions of exports and imports with Japan. For example, industries like automobiles, shipbuilding and home electronics may suffer from the enhanced international price competitiveness of Japanese products. The advantages enjoyed so far by those sectors will be lost due to the depreciation of the yen that will continue for the time being. However, industries like petrochemicals, and steel may not be much affected by the low yen because those exports are currently related to other factors such as the international condition of demand for them. The machinery industry may benefit from the low factor prices due to the low yen because most machinery firms import one-third of components from Japan.

The Korean government should prepare for a possible rapid contraction of the Korean economy so that it can achieve a soft landing. The government needs to work out a way in advance to stabilize the economy. It should not allow an excessive appreciation of the won. It is recommended that Korean firms properly use the hedging technique including using financial derivatives against future exchange rate fluctuations. In the long run, the Korean economy should alleviate the economic dependence on the Japanese economy, especially for capital goods and develop more value-added commodities. And every firm should reduce production cost through managerial efficiency and technical improvement.

(Kim Chan-Jin)

Exchange Rates