HIGH OIL PRICES DAMAGING KOREA'S ECONOMY

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Recently, the WTI 3-month futures price touched $25 per barrel, and the Dubai which takes more than 70% of Korea's oil imports also penetrated the $23 resistance line. Oil price seems to remain strong until early 2000 because the OPEC already reached an agreement that the current output quota assigned to each member countries should be kept to the next meeting on March. Also the oil demand steadily increases as the Asian economies recover and the winter season comes in the Northern Hemisphere.

Still, there are some potentially good news in the market. The spot market oil price will be determined by inventories, spot demand, futures and the willingness to adhere to the current quotas. Non-OPEC countries may increase production if high price over $20 a barrel continues, and eventually the OPEC could be tempted to break the agreement among themselves. The OPEC also knows that its market share could be seriously hurt in case of non-OPEC's output increase, especially in longer term supply contracts. Furthermore, industry experts think that trading on oil futures skews current prices in such a way that they do not reflect fundamental valuations. So average oil prices may fall below $20 a barrel during the next six months.

Even though oil prices retreat to $20 a barrel, however, the recent hike pushes up the production unit cost of Korea's industrial products, especially petroleum-related goods. Korea's oil import amounts to $10.4 billion in 1998, but it could reach $14 billion in 1999 with 880 million barrel imports on $16 per barrel and more than $20 billion in 2000 with 950 million barrel import on $22 per barrel, respectively. In other words, trade balance could be seriously hurt by more than $5 billion only for the oil price hike.

Furthermore, the 10% increase in oil price results in an economic slowdown of 0.5% point and worsens inflation by 0.8% point this year. Even though the recent yen's strength brings an improvement in the current account, a big jump in oil price aggravates overall economic situation more directly and immediately because it takes at least more than three months for the strengthened yen to stimulate Korea's export competitiveness. VIP

Table 1. The effect of Oil Price Hike on the Korean Economy

		1999	2000
CPI increase		+0.8%p	+1.8%p
	Manufacturing	+0.5%p	+1.1%p
	Services	+0.3%p	+0.7%p
GDP growth decrease		-0.5%p	-1.3%p
	Import	+1.98 biliion	+4.56 billion
	Export	-0.34 billion	-1.11 billion
	Trade balance	-2.32 billion	-5.67billion

Note: These figures are calculated on the assumption that average oil price is $16 a barrel in 1999 and $22 in 2000.