

# POSSIBILITY OF A BALANCED CURRENT ACCOUNT

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*Korea's trade surplus, which had lasted for 26 months since November 1997, ended in January 2000.*

With a dramatic increase in imports, Korea's trade surplus, which had lasted for 26 months since November 1997, ended in January 2000. Korea recorded a \$390 million trade deficit during January which surprised many economists and government officials who expected a longer-term trade surplus. Fortunately, the trade balance returned to the black in February. Imports surged 57.5% which was the highest increase since January 1988. But exports also increased enough to surpass imports in volume.

Table 1. Recent Korea's Exports and Imports

	(billion dollars)									
	97	98	99				2000			
			Q1	Q2	Q3	Q4	year	Jan	Feb	
<b>Exports</b>	136.2	132.3	30.3	35.7	35.1	42.6	143.6	12.2	12.8	
<b>(increasing rate, %)</b>	5.0	-2.8	-6.1	2.5	15.1	22.7	8.6	31.6	37.3	
<b>Imports</b>	144.6	93.3	25.6	28.8	29.8	35.7	119.8	12.6	12.0	
<b>(increasing rate, %)</b>	-3.8	-35.5	8.1	22.2	38.7	44.8	28.4	45.8	57.5	
<b>Trade Balance</b>	-8.4	39.0	4.7	7.0	5.3	6.9	23.9	-0.4	8.0	
<b>Current Account</b>	-8.2	40.6	6.2	6.4	6.7	5.7	25.0	-	-	
<b>Goods</b>	-3.2	41.6	6.8	8.0	6.9	7.1	28.7	-	-	
<b>Services</b>	-3.2	0.6	-0.2	-0.5	0.0	-0.2	-1.0	-	-	
<b>Income</b>	-2.5	-5.0	-0.9	-1.5	-0.7	-1.5	-4.7	-	-	
<b>Current Transfer</b>	0.7	3.4	0.6	0.4	0.6	0.4	2.0	-	-	

Source : Ministry of Commerce, Industry, and Energy.  
Bank of Korea

## Export climate will worsen in 2000

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In spite of the return to a trade surplus, some worries still remain. The climate surrounding Korea's exports is forecast to get worse. The oversupply of dollars in the domestic exchange market will invite the domestic currency's steady appreciation, which will hurt Korea's price competitiveness. Recently, the yen's depreciation has been another factor deteriorating price competitiveness. The surging oil prices are unfavorable for the trade balance, too. The significant increase of exports during the

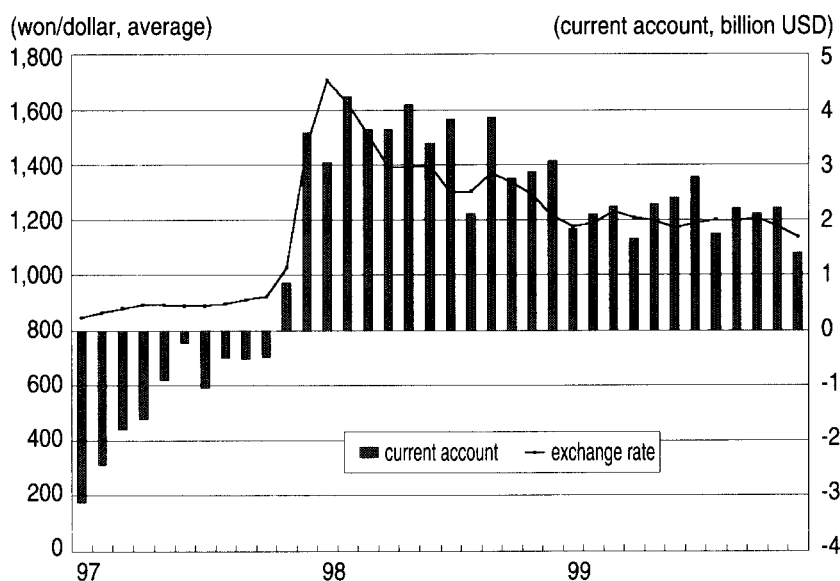
last two months does not seem to be positive proof of a large trade surplus hereafter because the exports during February, especially in the last few days, might not have been obtained in normal conditions. The trade balance recorded a \$100 million deficit until the last day of February, when the balance turned over to a \$900 million surplus owing to a dramatic surplus that day. This figure strongly implies that the government and private exporting firms made every effort they could to increase exports.

### What caused the last two years' surplus?

A decrease in the trade surplus will induce deterioration in the year's current account because the trade balance composes most of the current account. Before forecasting the current account in 2000, one thing must be determined: whether or not the current account surplus of the last two years was due to a structural change in Korea's economy. If changes in the economic structure occurred and made the current account return to the black, we must not forecast future current account balances with the assumption that relations among variables such as the current account, exchange rate, domestic growth rate, and overseas conditions will remain as they were before the crisis. On the other hand, if the huge current account surplus of the last two years was merely due to temporary contraction in demand and hikes in the exchange rate, we can expect the current account surplus to disappear as the Korean economy recovers from the shock. In short, the forecast of the current account depends on the existence of structural change. Of course, government policy would be different depending on whether structural change existed or not.

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Figure 1. Nominal Exchange Rate and Current Account



*Korea's current account surplus in 1998 is too big to be explained by a hike in the exchange rate and steep demand contraction.*

Some circumstantial evidence indicates that the surplus was due to structural changes. The current account surplus in 1998 was \$40.6 billion, which was 12.6% of Gross Domestic Product. Considering that Japan recorded a \$120.7 billion current account surplus which was only 3.2% of its GDP, one can see how great Korea's current account surplus was in 1998. It is too big a number to be explained by a hike in the exchange rate and steep demand contraction. Corporate restructuring could be another factor that changed Korea's economic structure. Firms are not expected to make as many large facility investments as they did before the economic crisis. It is well known that facility investments in some industries such as petrochemicals, automobiles, and ship-building induce a large amount of imports and trade deficit. But, owing to structural changes resulting from restructuring, one can expect that those industries will no longer bring high imports. Those who believe that structural change occurred attribute the recent rapid increase in imports to a hike in oil prices rather than a return to the past.

### **Rapid increase in imports may prove no structural changes**

But the opposing voices should not be ignored. They assert that the rapid increase in imports are only due to demand recovery and the surplus will disappear when the economy is recovering. According to this assertion, the huge current account in 1998 was due to excessive response to the shock. Investment and consumption shrank more than they should have during 1998, which resulted in an amazing surplus. If only the exchange rate mattered, the question can be raised as to why exports decreased during the period when exchange rate skyrocketed. And the excessive response to the shock was not a structural change.

The restructuring plans that have been carried out after the crisis have focused on business exchanges among conglomerates - so-called "Big Deals" - and improvement in financial structure in which the big companies must reduce their debt ratios below two hundred percent. Strictly speaking, the restructuring has nothing to do with industrial structure related to exports and imports. Korea depends on foreign countries for raw and basic materials, parts, and capital goods for exports, which means that more exports induce more imports. We can hardly expect that the restructuring plans have improved the import-inducing structure.

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It is not easy to judge which argument is correct at present. It is certain that the skyrocketing exchange rate was one of the major factors of the surplus. Then, what is another one? Structural change or excessive response to the crisis. Only time will tell, and the correct answer will be clear at the end of the year. But the best judgement we can make at the present time is that structural changes did not occur and even if they did, they explain only a small part of the last two years' surplus. We need to pay attention to the period between October and December 1997. In the former period Korea recorded a \$0.5 billion current account deficit and in the latter, a \$3.6 surplus. If structural changes played an important role in

keeping the current account surplus, it should be noted that the structural change occurred in a short time.

**Only structural changes will guarantee long-term balance on current account**

The hypothesis that structural changes occurred implies that Korea's current account will approach a balance or turn into a deficit. The government and most domestic firms seem to wish for a greater current account surplus. But, without structural changes, this might be almost impossible. This means that favorable exchange rate conditions cannot be the right answer for the Korean economy, and the effect of government policies focused on direct intervention in the foreign exchange market will be limited.

Structural changes will take a long time. During the period after the crisis, however, many are impatiently wishing for a surplus. In 1998 and 1999, the trade surplus deserved first priority, but now it is more important to build long-term competitiveness. We don't have to rush around in fear of a temporary deficit. **VIP**

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**Table 2. Arguments related to forecasts of current account**

	Structural Changes	Excessive Shrink in Demand
<b>Reasons for the surplus in 1998 and 1999</b>	<ul style="list-style-type: none"> <li>· hike in exchange rate</li> <li>· structural changes in the economy</li> </ul>	<ul style="list-style-type: none"> <li>· hike in exchange rate</li> <li>· excessive contraction in investment and consumption resulting from economic shock</li> </ul>
<b>Current account forecast</b>	<ul style="list-style-type: none"> <li>· surplus will decrease but will remain</li> </ul>	<ul style="list-style-type: none"> <li>· surplus will vanish along with economic recovery</li> </ul>
<b>Policy implications</b>	<ul style="list-style-type: none"> <li>· It is important to maintain price competitiveness by intervening in the foreign exchange market</li> </ul>	<ul style="list-style-type: none"> <li>· Only improvement in industrial structure can guarantee a long-term balanced current account</li> </ul>