



Opinions

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Will Current Account Surplus in Korea Be Sustainable?

Population Aging and Accumulation of Foreign Assets



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Korea has experienced a long-lasting surplus in its current account since the Asian financial crisis in 1998. Recently the surplus has grown wider, with Korea recording a current account surplus of 7.7 percent of GDP in 2015 and 7.0 percent of GDP in 2016. Such a persistent and massive current account surplus in one economy becomes a cause for country-level debates, and accordingly, Korea has been one of the countries suspected as a currency manipulator by the U.S. Treasury Department. The recent empirical studies such as Han and Shin (2016),¹ however, argue that the current account surplus in Korea reflects the consequences of rapid demographical changes in Korea. The surplus is expected to disappear within 25 years as Korea will become one of the most aged economies in the world. Here, we investigate what factors determine the current account balance and the recent current account surplus in Korea.

Using 48 country panel data for 1980-2015, we analyze the determinants of the current account by closely following the External Balance

¹ Han, C. and Shin, K. (2016), "What Explains Current Account Surplus in Korea?", KIEP Working Paper 16-15.

Assessment (EBA) methodology of the IMF and Han and Shin (2016). We find that the current account balance is statistically significantly affected by demographic factors, net foreign asset, the relative GDP gap, oil price, fiscal balance and real exchange rate. By adopting the method of Higgins (1998),² the age distribution provides heterogeneous effects on the current account balance. More specifically, 10%p increases of young and old (15- to 20-year-old, 65- to 70-year-old) population ratio lead 2%p decreases of current account balance, whereas a 10 %p increase in the middle-aged (50- to 55-year-old) population ratio leads 2%p increases in current account balance. Oil price is a crucial determinant of current account balance; 10%p decreases of oil price lead 0.8–1.4%p increases of the current account balance in the oil import economies. Depreciation of real exchange rate significantly increases the current account balance, but the size of the effect is limited; 15-20% depreciation of real exchange rate is required to make a 1%p decrease of current account balance.

As of 2015, demographic changes are the most influential factor of Korea's current account surplus in the long run. The changes of Korea's current account surplus between the 1990s and 2015 are mostly contributed by demographic factors (46%) and the unexplained components (50%), which can be interpreted as the other long-term structural changes in the Korean economy. In the short run, the sharp drop in oil prices in 2014 is the most influential factor for Korea's current account surplus. The changes of Korea's current account surplus between 2014 and 2015 can be explained by oil prices (32%), net foreign asset (18%), demographic factors (11%), and the relative GDP gap (7%). The real exchange rate contributes in the opposite direction, with an 11% reduction shown in Korea's current account surplus as the real exchange rate of Korea continued to appreciate since the global financial crisis in 2008.

Korea will have limitations in sustaining a large current account surplus as the working age population in Korea peaked in 2016 and will continue to decrease, and thus the contribution of demographic factors on the current account surplus in Korea will continue to weaken. Moreover, most other factors such as oil prices are exogenously given to the Korean economy, meaning that there are not many policy tools to deal with them. Thus, Korea needs to remain aware that a reversal in its current account could happen in the future. In the meanwhile, Korea keeps accumulating foreign assets from its persistent current account surplus. This can serve as an opportunity for the Korean economy as it will eventually lead to an in-

² Higgins, M. (1998), "Demography, National Savings, and International Capital Flows", *International Economic Review*, pp. 343-369.

crease in future primary income, and thus its current account surplus. Korea should be aware of the important role played by this accumulation of foreign assets. **KIEP**