




Opinions

How Do Exchange Rate Movements Impact Firm Performance in Korea?



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The exchange rate is one of the most influential variables on economic activities in a small open economy such as Korea. In an economy that highly depends on the external sector, exchange rate movements can affect exports and imports and ultimately lead changes in economic growth and national income. Also, they have a significant effect on the price level, which might impact the competitiveness of enterprises and employment decisions. Thus, policymakers keep their eyes on movements in the exchange rate and worry that appreciation of the exchange rate may have a negative impact on exports. In Yoon and Kim (2017), we investigate the effects of exchange rate changes not only on aggregate macro-level analysis but also extended on an industry- and firm-level analysis, which can provide richer implications as there are heterogeneous characteristics of industries and firms, such as export and import share.

According to firm-level analysis in Korea, the main findings are as follows: (1) Exchange rate changes do not have significant effects on firm productivity. However, the effects are different between the manufacturing and service sector. For manufacturing firms, 10%p appreciation of real

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exchange rate may lead to 2%p increase of firm productivity. For service firms, on the other hand, 10%p appreciation of real exchange rate may lead to 2-3%p decrease in firm productivity. This result is very striking. In general, the manufacturing sector is more likely to export than the service sector, so appreciation of real exchange rate may lead to a loss of competitiveness in the manufacturing sector of the foreign market. Thus, it is easy to expect such appreciation would have negative effects on the productivity of manufacturing firms. However, the empirical results show the opposite. (2) For the industries that are more linked with export (higher export share), appreciation of the real exchange rate causes a loss in the price competitiveness of firms and decrease their productivity; 10%p appreciation of real exchange rate may have an additional 1-1.8%p decrease of firm productivity for industries that only produce export goods, compared to industries that only produce domestic goods. On the other hand, firms with low exports and high reliance on intermediate imports show little impact on their productivity. These results are consistent with the economic theory, and this fact is confirmed in the micro-level data of firms in Korea.

We also analyze the exchange exposure of listed firms. The main findings are as follows: appreciation of the won/dollar exchange rate has a positive effect on a significant portion of firms in the short-run. This can be attributed to the fact that appreciation of the Korean won may increase the firm's value. However, the share of firms whose value is negatively influenced by appreciation of the won/dollar exchange rate relatively increases in the medium- and long-run. In particular, we find that firms with substantial external assets, firms with low external debt, firms with high capital adequacy ratio, firms with high cash holding ratio, and firms with high profitability are better at controlling for exchange rate changes.

In sum, the effects of exchange rate fluctuations vary across industries and firms. What we emphasize in this study is that devaluation of a nation's currency is not necessarily beneficial to its economy. Since firms have different characteristics from those whose exposure to the exchange rate is either positive or negative, it is analyzed that the depreciation of exchange rate does not necessarily provide favorable conditions across all firms. The sign of effects depends on the share of exports or intermediate imports. It is difficult to achieve industry-level targets only through exchange rate policies. Thus, it may be necessary to develop policies that can help to reduce the negative influences. [KIEP](#)