Economic Analysis

What Low Oil Prices Will Mean for the Korean Economy

Consumers and industries will benefit from lower oil prices, but there is a downside

Korea’s economic growth rate has been lower than expected in recent years. Overall economic sentiment continues to be negative due to the continued slowdown in consumption and sluggish corporate investment. Against this backdrop, there is growing interest in how international oil prices, which fell sharply last year, will affect the domestic economy. While forecasts regarding the global economic impact of the low oil prices are mixed, they are sure to have a significant impact on Korea, a country that relies heavily on imported crude oil.

As of 2013, Korea’s annual imports of oil, including both crude oil and processed oil, amount to USD 128.1 billion. Though the country exports processed oil products through the use of imported crude oil, net imports amount to a whopping USD 77.2 billion, or the equivalent of 5.9 percent of Korea’s GDP. This is high compared to figures for China (3.2 percent), Japan (2.4 percent) and the USA (1.5 percent), and stems from manufacturing’s large share of the Korean economy and the need for raw materials and logistics costs that ensue.

Low oil prices mean reduced fuel costs for Korean consumers. Total average Korean household consumption is about USD 2,500 a month. Fuel expenses account for 5.6 percent of this, at USD 130, which is higher than that of the USA (3.5 percent) and Japan (2.2 percent). Oil taxes account for more than half of the total oil price, imposing a financial burden on households. Lower oil prices will send down gas prices by 20 percent, which is likely to increase the real purchasing power of households. The prices of oil-reliant products and transportation-related costs are also likely to drop. Lower gas prices can result in an increase in leisure-related spending, such as traveling and other activities, as well.

Companies struggling due to the sluggish economy will also enjoy reduced production costs. The logistics industry will benefit most from such reduced costs, while the auto industry will see an increase in demand. Most industries are expected to benefit from reduced logistics costs. Despite an expected loss valuation in the oil-refining and petrochemical industry due to decreased values of the oil in stock, lower oil prices will translate into increased demand. They will have a positive impact on economic growth, as increased household income and corporate profits will stimulate consumption and investment. Analyses of statistics after 2010 show that a 10 percent drop in oil prices boosts the economic growth rate by 0.4 percentage points in Korea. There will, however, be a downside to lower oil prices. Greater deflation risk will curb demand. Though deflation risks are mostly in the Eurozone, Korea is not risk-free, as the price level has recently remained low. The consumer price growth rate this year is forecast to remain as low as that of the previous year, at 1.4 percent, while lower oil prices are expected to lower the consumption price by 1 percentage point. Households tend to delay consumption when there is a risk of deflation. Corporations, in particular, will hesitate to invest when they expect a decrease in price-sensitive revenues due to deflation. Also of concern is the growing risk of a foreign exchange crisis in oil-producing countries. If oil producers such as Russia fall into default mode due to decreased exports caused by low oil prices, this will send significant shockwaves into the global financial market. In such a scenario, Korea would see a rapid outflow of foreign capital, followed by a surging foreign exchange rate and capital crunch.

Considering all the possible downsides, low oil prices will not stimulate demand as much as they did in the past. The Korean economy is expected to recover, spurred by low oil prices, but at a moderate pace.

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