The Strong Yen: A Gleam of Light for Korean Exports

Amidst the slow economic growth rate, the strong yen is good news for Korea's export market.

Never has the economic outlook looked gloomier than now. Amid more than eight years of low interest rates, the US economy isn't recovering fast enough for the Feds to raise the base rate. The IMF and World Bank continue to lower their forecasts as the world economy doesn't seem to be recuperating. China, the world's economic juggernaut, is still struggling to get out of the economic slump. Despite the quantitative easing and the negative interest rate, Japan hasn't convinced the world that its economy is recovering. Across the channel, the UK is trying to launch another grand-scale shock of Brexit on the European Union.

With such prolonged challenges, it's been difficult for Korea to achieve the vision of sufficient economic recovery and people's happiness promised by President Park Geun-hye in her inauguration over three years ago. Indeed, nobody can turn a blind eye to how hard the President has been working to achieve her four inaugural pledges: economic reconstruction, people's happiness, cultural revitalization and the base for peaceful reunification. The current administration's economic scores, however, have so far been rather lackluster; growth rates dipped to 2 percent, private consumption hardly increased more than 2 percent and private investment growth remains in the negative domain. Exports recorded negative growth for a record-breaking 17 consecutive months. The government has taken all initiative to get out of the economic slump through expansionary spending, investments in infrastructure, supplementary budgets and the lowering of interest rates six times from 2.75 percent to 1.25 percent.

But this doesn't mean that the Korean economy is doomed. In fact, it's far from it, thanks to the strengthening Japanese yen. The yen was 122 per dollar by the end of November, but as of June 16 this year, it was worth 103 per dollar, appreciating by more than 15 percent in less than six months. The yen gets stronger as global financial markets get mired in risks and uncertainty—this time it was Brexit.

The strong yen is crucial for Korea's economic growth as it helps create competitiveness for Korean exporters against Japanese products on the one hand, while also encouraging domestic suppliers to compete against Japanese imports inside Korea. If the yen gets weaker, Korea's trade and economy will be hit hard, making exports more sluggish while imports begin to surge. As exports and imports altogether make up almost 100 percent of the country's GDP, nothing seems more important than the yen's exchange rate for Korea's trade and economy.

History is full of such evidence. The first notable example was during the mid-1980s when the yen plunged from 250 to 120, appreciating about 50 percent as a result of the Plaza Agreement. From 1986 to 1988, the Korean economy recorded 12 percent growth and a huge trade surplus for the first time in its history. The second major case was during the early 1990s. The yen rate was 159 in April 1990 but dropped to 84 in March 1995, and the Korean economic growth reached 9.2 percent in 1994 and 9.5 percent in 1995. The third case was from June 2007 to December 2011 when the yen rate dropped from 123 to 78, an appreciation of almost 38 percent. The global economy was suffering from a major financial crisis after the sub-prime mortgage collapse. But Korean exports showed a growth of 28.3 percent and 19.3 percent growth in 2009 and 2010, respectively, and its economic growth rate was 6.5 percent in 2010 and 3.7 percent in 2011. These were amazing statistics compared to those of other countries, as most of them were suffering from negative growth and exports.

Only one reservation to that optimism is the lag in time. According to statistics, it usually takes more than two years for the yen's exchange rate to have a meaningful impact on trade and economic growth. There are a number of reasons why it takes times for the exchange rate to take effect. One is that it takes time for companies to change their export price, and the other is the inventory adjustment that takes place after the rate change.

Accordingly, it will take another year and a half to truly feel the effects of the yen back when it was strong in November 2015. Of course, it would be ideal if the yen doesn't reverse its course but it's difficult to predict which direction it will be going. Japan may try to take further quantitative easing measures and pursue the policy of the weaker yen as it has been since Prime Minister Shinzo Abe took office. If that happens, Korea's economic optimism could diminish. But if Brexit turns out to be a reality, ensuing financial turmoil would make the yen very strong and the Korean won very weak. Although Brexit isn't what Korea wants, one of the consequences of the stronger yen could become an exit for Korea to get out of the prolonged export slump.

By Professor Se Don Shin
Dean, Sookmyung Women’s University
Former Senior Economist Bank of Korea
seshin@sm.ac.kr