

Analysis of Factors Behind Korea's Current Account Surplus

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Korea's current account surplus has been in the black since 2000. As the surplus has widened considerably since 2012 in particular, Korea's current account surplus-to-GDP ratio has risen by around 3.5%, from 1.5% on average between 2000 and 2011 to the 5% range between 2012 and 2021. This paper looks into the reasons for this surge in the nation's current account surplus through empirical analysis, and based on this forecasts the future trajectory of Korea's current account over the medium- and long-term horizon. The analysis employs panel data of 49 countries. While this report applies the IMF's External Balance Assessment (EBA) among the country panel models widely used in analyzing the current account, it also takes into account variables including GVC participation, which has been considered important by researchers lately, as well as reliance on the manufacturing sector.

The empirical analysis using the country panel model estimates that the surge in Korea's current account surplus since 2012 has been attributable mainly to long-term structural factors and mid-term macroeconomic conditions, and the effect of these factors has been dominant since 2018 in particular. It is analyzed that the contribution of long-term structural factors to the current account surplus has exhibited a secular increase, stemming not only from demographic changes (static effect) such as the rise in the ratio of prime savers, but also from stronger incentives for saving for retirement (dynamic effect) in line with rapid population aging. Over the medium term, the increase in primary income due to the shift to positive net external assets, favorable

fiscal balance compared to advanced economies, and greater GVC participation have played a role as well. In contrast, the contribution of temporary factors (GDP gap and international oil prices) has been fluctuating without showing any particular trend, and the contribution of financial factors including foreign exchange rates was not significant. Meanwhile, since this paper's panel model does not consider country-specific characteristics, residuals tend to be large in more than a few areas when conducting a country-by-country analysis. As for Korea, it is found that the IT business cycle explains this residual for the most part.

We forecast the medium- to long-term trend of the current account based on the outcome of the empirical analysis, and find that the contributions to the current account surplus of the demographic structure, and of the fiscal balance, which has greatly affected Korea's recent current account surplus are expected to decrease gradually in the future. The contribution of the demographic structure to the current account surplus appears to have nearly reached its peak, and is expected to transition to a modest decline due to the rising old-age dependency ratio as population aging progresses going forward. The contribution of the fiscal balance to the surplus is expected to decrease moderately in line with the increase in social welfare spending. In contrast, the gradual expansion of net external assets' contribution to the current account surplus due to the accumulation of the surplus is likely to offset some of the decreasing contribution of demographic factors and the fiscal balance.

Given that the recent increase in the current account surplus is mainly attributable to medium- and long-term factors, the volume of the current account surplus this year is projected to be 5% relative to GDP. Moreover, even if the economy shakes off the pandemic shock and normalizes, the trend of massive surpluses is not expected to worsen in the short term. Since the

current account surplus can create imbalances to the economy, excess surpluses need to be addressed. Considering Korea's position as a country with a non-reserve currency, however, this trend of the current account surplus is assessed to contribute to enhancing external stability.

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