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tion, generally works well, except for the case of very persistent technology shocks. However, exactly how costly is it for the Bank of Korea to deviate from the optimal policy rule? The numbers reported in table 8.6 seem to suggest that the cost might not be very large. I would like to see the authors discuss the economic significance of the numbers reported in table 8.6, as well as their implications for monetary policy in practice.

Comment Mohamed Rizwan Habeeb Rahuman

Generally, this chapter is timely as it attempts to discern the reasons for the recent rise in oil prices and the macroeconomic impact it has on South Korea. The authors attribute the recent oil price shock (especially since 2003) on demand conditions, which is distinct in character from previous oil price shocks that were mostly supply shocks. On this point, this discussant concurs fully with the authors, and indeed, it is clear that the authors were inspired by James Hamilton's seminal works (Hamilton and Herrera 2004; Hamilton 2008, 2009) that lead to this conclusion as well.

However, I have some comments. The authors mention the inherent "battle" between headline inflation and core inflation in determining the function of oil shocks on the macroeconomy, especially in setting monetary policy. Though the chapter seems to lean toward Hamilton's contention that oil price shocks, due to their increasingly permanent nature, cannot be treated as transitory and headline inflation must be paid close attention by central banks, the authors shied away from making a clear argument. I believe a thorough discussion on this issue, and clearly stating which way the authors believe the direction should be taking, would not only strengthen the argument of demand-shock role of oil prices that this chapter wants to make, but also would serve to influence many central bankers in deciding the role of oil price shocks in setting monetary policy.

The authors inserted a clear "structural break" in the data set, separating the data set for the Korean economy between "pre-crisis" (which is 1970 to 1997) and "post-crisis" (which is 2000 to 2009). The years 1998 and 1999 were omitted, as the authors argued that these two years saw the Korean economy moving to a free-floating exchange rate system, and adopting an inflation-targeting regime. I believe this structural break could have led to a flawed data set, as the years 1998 and 1999, the years of the Asian Financial Crisis, also led to a sharp decline in oil prices (hitting the trough of US$10 per barrel in September 1998) due to negative demand shock from East Asia. Just as the authors intend to investigate the positive demand shock

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on oil prices on the Korean economy, the data set must include the negative demand shock on oil prices on the Korean economy experienced in those two years. This critical omission will, in the discussant's humble opinion, affect the conclusions of this chapter. I suggest the inclusion of the 1998 to 1999 data, with perhaps a dummy variable introduced to address the author's concerns on the changes in the Korean economy during the time period.

This chapter makes an extraordinary finding that the effect of the demand-led oil price increase post-crisis on GDP and inflation has been far more muted than the pre-crisis oil price increase. In other words, in pre-crisis, the oil prices and GDP growth were negatively correlated, while in the post-crisis, the effect of oil price on GDP growth is almost flat. To discover such conclusions in an oil-importing country such as Korea is surprising, and yet supports the discussant's view that oil price movements are increasingly demand-led and relate to economic growth much more strongly than in the 1970s and 1980s.

The chapter argues that if monetary policy (MP) behaves in an anti-inflationary manner toward rises in oil prices, especially if it is demand-shock driven, the resultant decline in oil price inflation would be matched (or overriden, even) by higher output gap volatility, affecting GDP growth. If MP is accomodative however, the opposite is true. I agree with the findings, but I wonder what the authors would have recommended a central bank to do, depending on the MP methodology. Again, the authors shied away from taking a stand on this issue, which considerably weakens their argument.

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