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Paper: Oil and the Macroeconomy: A Case of Korea

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Comments by discussant:

Generally, this paper 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 which 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 (2005, 2008 and 2009) that lead to this conclusion as well.

However, there are some comments by the discussant on this paper:

a) On page 3, there was mention of 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 paper seems to lean toward Hamilton's contention that oil price shocks, due to its 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. The discussant believes a thorough discussion on this issue, and clearly stating which way the authors believe should be taking, would not only strengthen the argument of demand-shock role of oil prices which this paper wants to make, but also would serve to influence many central bankers in deciding the role of oil price shocks in setting monetary policy.

b) On page 5, the authors inserted a clear 'structural break' in the data set, separating the data set for the Korean economy between 'pre-crisis', which is 1970-1997 and 'post-crisis', which is 2000-2009. 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. The discussant believes 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 USD10 per barrel in September 1998) due to negative demand shock from East Asia. Just as the authors intend to investigate the positive demand shock 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 paper. The discussant suggests the inclusion of the 1998-1999 data, with perhaps a dummy variable introduced to address the author's concerns on the changes in the Korean economy during the time period.

c) This paper 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 a oil-importing country such as Korea is surprising, and yet supports the discussant's view that oil price movements is increasingly demand-led and relates to economic growth much more strongly than in the 1970s and 1980s.

d) The paper 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. The discussant agrees with the findings, but wonders what the authors would have recommended to 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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