Re-evaluation of Reduction in Economic Volatility

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Since the global financial crisis, the economic volatility of Korea has been reduced markedly. Generally, a reduction in economic volatility is perceived as a natural phenomenon stemming from the maturity of the economy or an improvement in the effectiveness of economic management. However, it can also be caused by factors such as reduced economic dynamism and heightened risk aversion by economic agents. Therefore, in order to accurately understand a reduction in economic volatility, the phenomenon must be approached from multiple perspectives.

Against this backdrop, this paper looks into the characteristics of recent economic volatility in Korea, which include not only the usual macro volatility, but also micro volatilities, which reflect corporate dynamics. This paper then makes an in-depth analysis of the causes of the reduction in economic volatility, using both qualitative and quantitative methods, in terms of shocks and their effects.

The main results of the analysis are as follows: First, the reduction in economic volatility in Korea is more marked than those in major countries and is concentrated in household consumption and corporate investment in terms of GDP expenditure sectors. In addition, in terms of the stage of the economic cycle, the reduction is more noticeable in the expansionary phase than in the contraction phase. Second, volatilities in micro indicators have decreased simultaneously with those of macro indicators, which is contrary to what was seen in major countries such as the US and the UK during the period of the Great Moderation. Third, the reduced economic volatility is estimated to be attributable to reduced positive shocks in global economic activity and productivity, and to weaker responses to them from economic agents such as households and corporations.

Considering these analysis results, the recent reduction in economic volatility in Korea is not expected to have the positive effects seen during the period of the Great Moderation. During that period, with innovation activity being brisk and

expectations for economic expansion increasing, economic agents had higher tendencies to spend and invest. Meanwhile, in Korea, with innovation activity slowing, economic agents show more conservative behaviors. This is because the recent reduction in economic volatility is largely attributable to lessened overall vitality, rather than to economic maturity.

In a situation where there is no noticeable economic volatility, as seen recently, there is a greater possibility of error in identifying the stage of the economic cycle, and thus caution should be exercised in doing so. When private consumption is sluggish and economic volatility is driven by exports, whose cycle is short, economic activity may end up in a minor cycle. Therefore, it is desirable to focus more on developments related to domestic demand and track economic movements over a medium-term horizon. In addition, it is essential to heighten the accuracy of economic analysis through close monitoring of the nature, magnitude and origin of shocks at home and abroad and through analyses of changes in the behaviors of economic agents.

Furthermore, to strengthen recovery momentum in the Korean economy, more focus should be put on policy efforts to improve productivity by expanding the stable income base for households through job creation, and by augmenting the innovation capacities of corporations.

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