

Analysis of Price Stickiness with Use of Individual Price Indexes

Price stickiness affects how fast and to what extent the real economy adjusts itself to various economic shocks and therefore has significant implications for the implementation of monetary policy.

There are not many empirical analyses, and not a single micro-level study, on price stickiness in Korea. In this regard, the trend and characteristics of price stickiness are analyzed in this study with the use of individual price indexes and policy implications are drawn based on the analysis.

The results of the analysis suggest the following as the characteristics of price stickiness in Korea: first, since the financial crisis of the late 1990s, individual prices have fluctuated more frequently and within a narrower range during a month. This suggests that price stickiness is easing structurally, with individual prices showing more frequent changes in a narrower range than before. Second, since the financial crisis, changes in the frequency of price fluctuations have been most evident in industrial products; their prices have experienced increasingly large decreases and this is more apparent for traded goods than for non-traded ones. This seems attributable to structural changes in the economy — large corporations losing their power of price monopoly, improved distribution systems and fiercer competition between domestic and foreign corporations along with the advancement of globalization. Third, agricultural, animal husbandry and fisheries products have exhibited the most frequent price changes, followed by industrial products and services. Fourth, how frequently individual prices change has been affected by how consumer prices as a whole and those of items within the same category changed over the previous year.

The analysis that Korea's price stickiness has considerably eased since the financial crisis offers the following implications for the monetary policy implementation: first, prices change more flexibly under the impact of economic shocks from home and abroad, and therefore adjustments of production and interest rates are made within a narrower range than before. This shows that fine-tuning is, in contrast to the past, a good choice as a policy measure against economic shocks.

Next, it is necessary to look closely at movements of individual prices, figure out which specific individual prices are subject to pressures, and reflect the price stickiness of these specific items in the short- and long-term inflation prospects. When developing policy measures for medium- and long-term price stability, it would be wise to put more emphasis on items with a higher degree of price stickiness.

Particularly, it is advisable to implement policy measures with more emphasis placed not on items (mostly industrial products) whose prices show frequent downward movements but on those showing frequent upward price movements and greater price stickiness (mostly services).

Finally, given that price determination behaviors in the services sector serve as a factor weakening price stability, with services sector prices exhibiting less frequent downward movements and, once adjusted upward, remaining unchanged for a much longer period than before, efforts need to be made to enhance price flexibility in the services sector by way of strengthening the market environment for competition.