

Analysis and Implications of Industry specific Factors Causing Changes in Production since the Global Financial Crisis

Bae Sung Jong*, Lee Eun Seok**, Park Sang Woo***

With uncertainty about the Korean economy easing and global economic conditions showing gradual improvement this year, its economic growth rate is expected to rise above that in the previous year. Concerns, however, have been raised that, due mainly to the lackluster business performance in the construction sector stemming from the housing market slump, and to sluggishness arising from fiercer competition with China in some traditional mainstay sectors of Korean industry, it will be difficult for the Korean economy to show significant improvement, even if it does actually recover going forward. These concerns seem to be mainly attributable to the view that, since the financial crisis, growth in the Korean economy may be limited, as apart from cyclical factors, idiosyncratic factors by industry has increased.

This paper examines what distinctive changes took place in the variations in production by industry in the Korean economy before and after the financial crisis and conducts an empirical analysis to find if these changes were more heavily influenced by cyclical factors or by idiosyncratic factors by industry after the financial crisis.

The results of the empirical analysis show that, in the case of services and construction, the relation between production and the business cycle has weakened greatly since the financial crisis, and its divergence from the business cycle has shown a widening pattern. Manufacturing production has widened the range of domestic economic fluctuations by fluctuating more widely than economic activity as a whole has acted to heighten the amplitude of the fluctuation of the overall economy. Meanwhile, construction and services production, the latter of which had served as cyclical buffer, have acted to dampen the economic recovery from the

financial crisis by shrinking by a wider range than the economy as a whole. The results of the decomposition of fluctuations in production by industry into cyclical factors and industry-specific idiosyncratic factors shows that the recent sluggishness of the Korean economy is not just due to cyclical factors but also to a considerable extent to industry-specific idiosyncratic factors. In the case of manufacturing, idiosyncratic factors such as the expanded offshore production (IT manufacturing, etc.) and the prolonged domestic real estate market downturn (non-metallic minerals) have served as negative factors. As for services, the decline in housing transaction volumes and the lackluster state of domestic demand stemming from the prolonged uncertainty are analyzed as having had negative influences.

These analysis results imply that, in order for the recovery of the Korean economy going forward, there is a need to consider not only monetary and fiscal policies from a macroeconomic perspective but also micro-level policy responses oriented to the reinvigoration of individual industries, including services and construction, or to idiosyncratic factors by industry including the easing of expectations of housing price decline and the setting of incentives for the repatriation of offshore business activities.

* Senior economist, Industry Analysis Team, Research Department (Tel : +82-2-759-4427, e-mail : intbae@bok.or.kr)

** Economist, Industry Analysis Team, Research Department (Tel : +82-2-759-4484, e-mail : eunseok.lee@bok.or.kr)

*** Junior economist, Industry Analysis Team, Research Department (Tel : +82-2-759-4226, e-mail : lemonmint@bok.or.kr)

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