Monetary Policy with Demand and Supply Shock in Korea

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This paper identifies the demand and supply shock using the structural vector-autoregressive (SVAR) model and recovers the Taylor rule from the model. It was found that the 2008 crisis was characterized as the demand-shock crisis. But the high inflation in 2010 reflected the supply shock rather than the demand shock, but that in the first half of 2011 reflected the demand shock rather than the supply shock. The demand shock increased the growth and inflation in the short run, while the supply shock decreased the growth and increased the inflation. When the call rate is not differenced as in the conventional interest reaction function, it responded positively to the demand shock, but negatively to the supply shock in the short run. The call rate responded positively to the supply shock in the long run. Korea's monetary policy became more stable with the introduction of the inflation targeting system. However, Korea's monetary policy was accommodating under the inflation targeting.