Policy Mix for Revitalizing Domestic Market

The expansionary combination of fiscal and monetary policy is urgently required

A social consensus on the need to reinvigorate domestic demand is being formed following the depression of the domestic market in the aftermath of the Sewol ferry disaster in April. I’d like to suggest directions for fiscal, monetary and microeconomic policies for domestic economic recovery.

Risk of depressed domestic market brought by Sewol ferry disaster

The shock of the Sewol ferry disaster had a demoralizing influence not only on private consumption, but also on the domestic economy as a whole including production, investment and employment, causing growing concern over the risk of domestic market deflation. The production growth rate of the mining and manufacturing industries plummeted in April / May to -1.4 percent from 0.3 percent in the first quarter, and the service industry also sharply fell from 0.5 percent to -0.7 percent. Retail sales dropped from 0.3 percent to -0.9 percent, although facility investment rose from -5.2 percent to 2.3 percent, which is attributed to the base effect. The number of new employments fell in May / June to 406,000 from the January-April average of 693,000. The Sewol ferry disaster dealt a severe blow especially to small business owners (self-employed businesses run by one person), reducing the number of single-person, self-employed businesses by 44,000 in May / June. Although the Sewol ferry disaster shock was expected to last for more or less three months and be mainly confined to private consumption, the worry now is that it will persist in the second half of 2014, having a negative effect on the domestic economy as a whole, including production and investment.

Deterioration of actual economic sentiment

The gap between the economy as measured by indices and the economic sentiment actually felt by consumers is widening as net exports rise despite a domestic depression. As the table below shows, the GDP growth rate is likely to be 0.7 percent in Q2 thanks to increasing net exports. However, the Consumer Sentiment Index plummeted in May by 15p, from 91 to 76, drifting further away from the baseline 100, and remained at 79 in June, showing no sign of tangible recovery. The Business Sentiment Index dropped: The manufacturing industry’s BSI fell between April and June by 5p (82 → 79 → 77) and non-manufacturing industries’ BSI also fell by 5p (71 → 69 → 66).

Policy suggestion for revitalizing domestic economy

1. The expansionary combination of fiscal and monetary policies is urgently required. A budget expansion has always been drawn up in the time of economic crisis, which has invariably revitalized the domestic economy. Lowering the base interest rate has also contributed to economic recovery. In the case of fiscal policy, every available means should be mobilized, including funds disposable without the resolution of the National Assembly, the early execution of public expenditure and the expansion of policy financing. When it comes to monetary policies, preemptive measures should be taken considering that the effect of lowering the interest rate comes more or less six months after action is taken. The time in which the base interest rate is lowered should be advanced, and an extension of the cap of financial intermediary support loans should also be considered.

2. A virtuous circle, which means that the boosting of the real estate market leads to recovery of domestic demand, should be established. It is necessary to revise the loan-to-value ratio upwards and increase the debt-to-income ratio to a reasonable level that would not harm financial stability.

3. The “3-year plan for economic innovation,” which suffered a temporary setback in the wake of the Sewol ferry disaster, should be robustly and consistently promoted. Investment-related regulations should be eased and household spending power should be strengthened. In addition, growth potential needs to be expanded through enforcing the economic constitution.

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