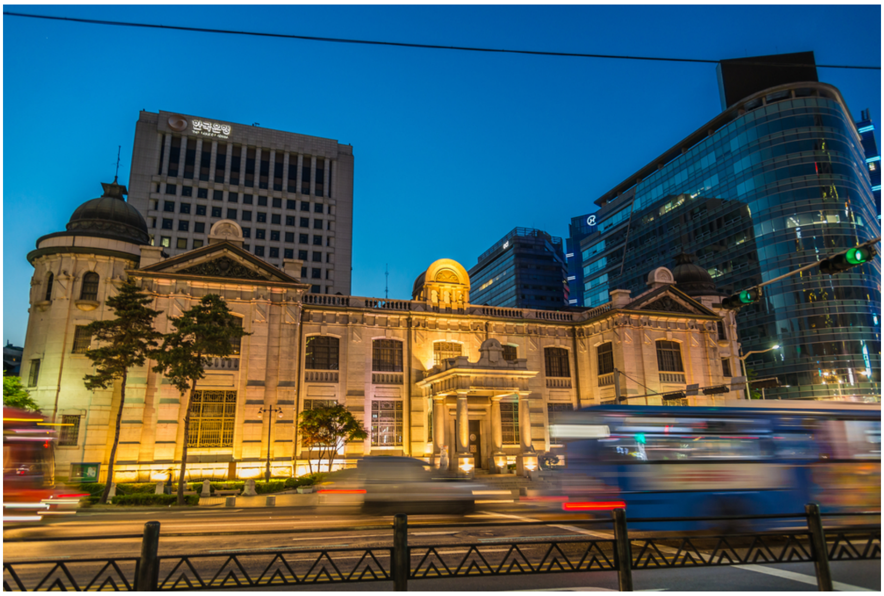
Bank of Korea - looking through labour weakness

Not one single forecaster expects the Bank of Korea to cut rates again this week despite a very soft labour report for December. We agree, but the consensus probably underestimates the risks of some further easing



Source: Shutterstock

Can the consensus all be wrong?

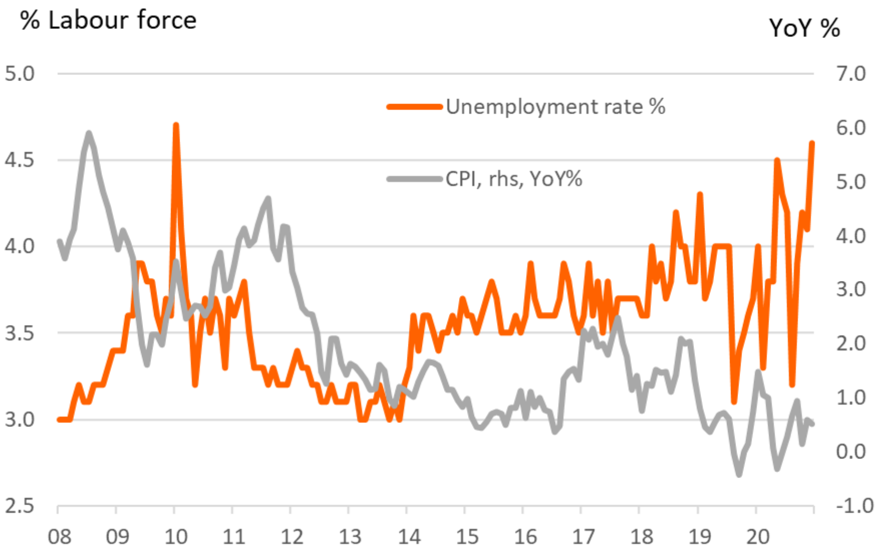
It is unlikely that the twenty out of twenty economists that have all predicted no change at Friday's Bank of Korea rates meeting will be wrong. But most of the forecasts will have predated the very weak labour report for December that was released on 13 January.

That release showed a large fall in employment that was almost exactly mirrored in rising unemployment. If that sounds obvious, it isn't. Employment and unemployment are rarely mirrors of one another, so when that does happen, it does hint that the two are related, and in this case, that lost employment has led to rising unemployment. That isn't a favourable backdrop.

The Korean unemployment rate in December rose from 4.1% to 4.6%. Unemployment rates are "nasty" and unreliable bits of data and need to be treated with great care. But one of the things that often drive big upswings in the unemployment rate - a surge in the labour force - did not happen in December. Indeed, quite the opposite. So it all begins to look as if this was a genuinely weak release and one that could realistically be taken into account in the coming BoK meeting.

So why won't it?

Korea unemployment rate and inflation



Source: CEIC

Korea unemployment rate and inflation

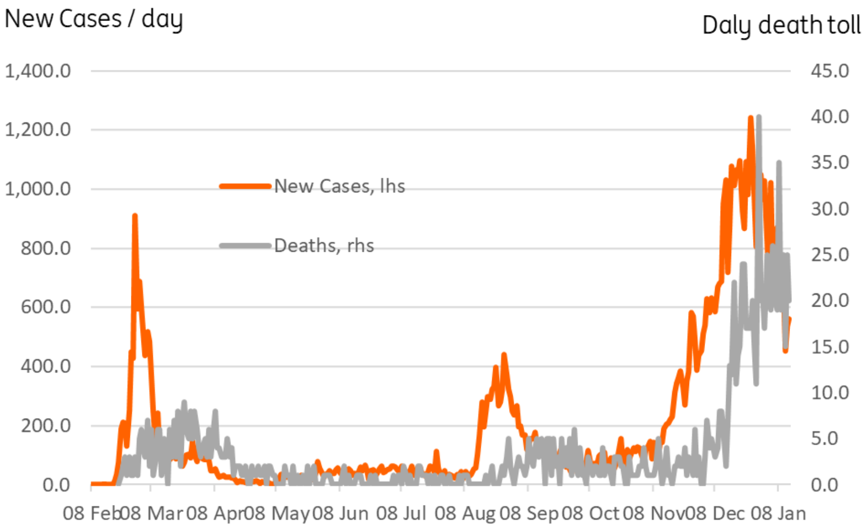
Inflation is not a great reason not to ease further

One of the other arguments often used for justifying monetary accommodation, inflation, is not much help either for the "no-cut" camp. Current headline inflation is only 0.5%. But like many other economies around the world, headline inflation rates in Korea are heavily depressed by the negative price effects stemming from the Covid-19 pandemic's first hit in March to May of 2020. What this means is that if the current run-rate of inflation persists into 2021, then we should expect inflation to pick up through the second quarter of this year, and could even come quite close to 2.0%YoY by mid-year. So although current inflation rates look supportive for further easing, a bit of further consideration suggests that it isn't.

Covid-19 is not a good argument for easing

The recent Covid-19 figures for South Korea haven't been fantastic, but by international standards, they remain extremely good. Average daily cases are currently about 600, which is well down from 1000+ which they were a few weeks ago. If you think about the 5,000 plus cases in Japan, 10,000 plus cases that are being counted in Indonesia, or the 45,000 or so cases in the UK currently recorded, then Korea is in fact doing remarkably well, something we have documented in longer pieces on this economy. But it is also fair to say that the political tolerance for Covid in Korea, as in much of the rest of Asia, is very low, and restrictions on movement could be introduced at much lower levels than in Europe or the US. But in any case, there isn't much of a role for a further 25bp of rate cuts at present, in the face of the current Covid problems. Rate cuts don't stop the virus.

Korea Daily Covid cases and death toll



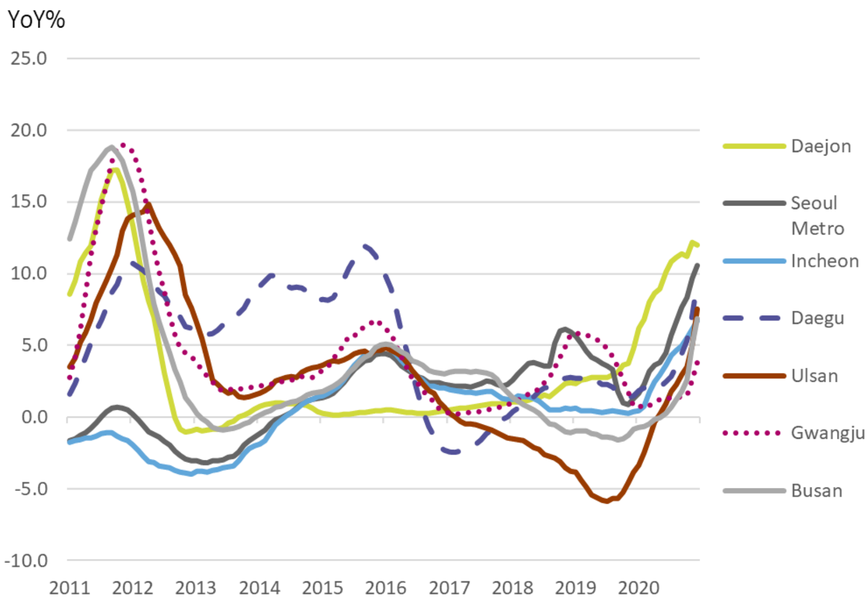
Source: CEIC, WHO

Korea daily Covid cases and death toll

Political opposition to rate cuts

One thing we shouldn't discount in this consideration is the political concern in Korea about the rates of household debt and house price inflation. House price inflation nationally is about 8.3%YoY, but it is much higher for the Metropolitan Seoul area and Daejon, exceeding 10% in both regions. This is a big political concern, and the Bank of Korea is not insensitive to the government's worries, presenting a further reason for the BoK not to respond this week with further easing.

Korean house prices rise



Source: CEIC

Korean house prices

Summary

So can you make a case for a further rate cut this Friday? Yes. But it isn't a particularly robust one. It rests on cutting for the sake of cutting, realizing that it won't actually do a great deal of good, but that it is better to be seen to be doing something even if that something is a bit pointless.

I don't think that is a sufficiently compelling argument for the Bank of Korea in the face of arguments not to act, and nor does it seem that anyone else does either. That is not to rule out a rate cut completely. The KRW may have a small rally on the day in the event that the BoK does nothing as expected. Further moves in the KRW will be dominated by USD trends.

Author

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com