Korea: Central bank starts easing cycle with 25bp rate cut

The Bank of Korea's rate cut today is a mere reversal of a 25 basis point hike in November 2018 rather than a real policy stimulus for the economy, which is close to or already in recession. We believe this is just the beginning of the easing cycle

The Bank of Korea is caught between a weak currency and weak growth

Source: Shutterstock

1.50%

BoK policy rate

After 25bp cut today

Lower than expected

A surprise for the market, not for us

The Bank of Korea (BoK) surprised the market today by cutting its policy rate by 25 basis point to 1.50%. The consensus was still largely in denial of easing; 15 out of 25 participants in a Bloomberg survey expected no change, with many likely expecting the BoK to wait until after the Fed rate cut later this month. We were in the minority forecasting a 25bp rate cut.

> *As it is expected that domestic economic growth will be moderate and it is forecast that inflationary pressures on the demand side will remain at a low level, the Board will maintain its accommodative monetary policy stance. - BoK policy statement*

The policy statement pointed to a deepening slowdown in exports and construction and facilities investment, while inflation continued to be low and falling short of the central bank's projected path. The statement also signalled a downgrade of the central bank's growth and inflation forecasts for this year, while Governor Lee Ju-yeol formally announced new forecasts in his press conference subsequently.

Policy guidance of more easing ahead

The BoK governor's press conference typically steals all the market attention on these decision days. And the focus is especially more intense when the policy is actually changed, just as it is today. The key takeaways from his remarks are:

- **Weak economic outlook:** Downgrade of forecast GDP growth in 2019 to 2.2% and CPI inflation to 0.7%, from the previous forecasts 2.5% and 1.1%, respectively in April. This is BoK's fifth forecast downgrade over the last 12 months, putting growth at the lowest level since the 2008-09 global financial crisis.
- **Trade rift with Japan:** Given the scale of bilateral trade, Governor Lee warned about a significant impact on the Korean economy in the event that Japan's export restrictions against Korea become a reality and even broaden, though it's hard to gauge the actual impact.
- **Market volatility:** No clear direction on (KRW) exchange rates with changes in expectations about the Fed policy and uncertainty from the US-China trade war adding to FX market volatility. A rate cut could have a negative impact on financial stability.
- **Housing market risk:** A rate cut could fuel a further surge in housing prices, though that's probably more a concern for the government, which has a strong will to curb home prices.
- **Policy guidance:** Growth takes priority over financial market stability. Yet, undermining the impact of today's rate cut, Governor Lee sees monetary policy at a level that doesn't hurt the real economy, though the central bank could still take policy action to some degree as it has yet to reach its effective bottom for lowering rates.

Here's what we think

Today's policy rate cut is a mere reversal of a 25 basis point hike in November 2018 and doesn't represent a real policy stimulus for the economy, which is close to recession. Watch out for next week's release of preliminary GDP figures for 2Q19. GDP contracted by 0.4% in 1Q19 from the previous quarter. Another such (quarter-on-quarter, seasonally adjusted) contraction would confirm the (technical) recession.

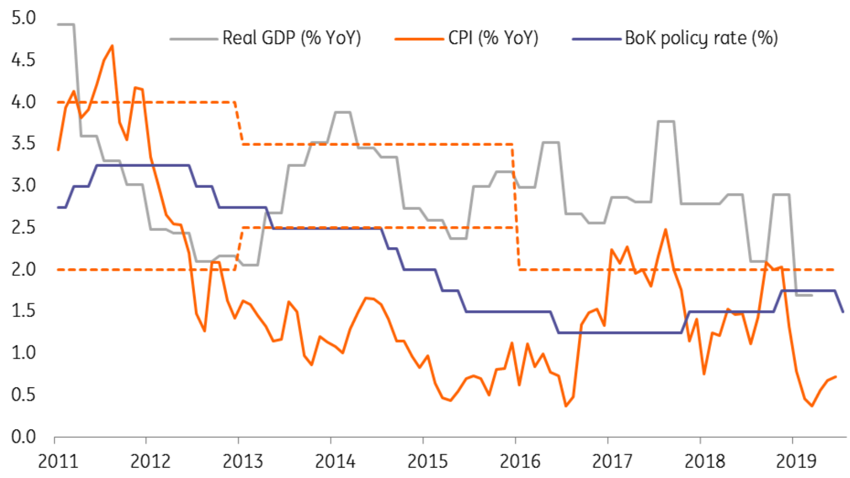
The Korean economy may actually be in a recession right now, we're simply waiting for the data to confirm it. - ING Asia Chief Economist, Rob Carnell

We believe this is just the beginning of an easing cycle and there is more to come. Just as the US-China trade friction, Korea's trade tensions with Japan could get worse before they get better. With the growth outlook likely turning gloomier in the rest of the year, the BoK will be forced into more policy easing. We consider our forecast of a 1.25% policy rate by year end subject to more downside than upside risk.

One could view the year-to-date KRW underperformance as the market appreciating the need for easier policy, and thus getting the central bank to deliver on it. If so, the worse of the KRW performance this year is probably over. We think the markets are already pricing in more BoK rate cuts ahead. And with the imminent Fed rate cut supporting the weak US dollar trend ahead, we don't see today's rate cut or future moves as having much of a detrimental impact on the Korean won (KRW). Our year end USD/KRW forecast remains at 1180 (spot 1177).

[Is the South Korean economy headed for a recession?]

Growth, inflation and Bank of Korea policy rate



Dotted lines are BoK's inflation target, shifted from a range to point target in 2016.

Source: Bloomberg, CEIC, ING

Author

Alissa Lefebre
Economist
alissa.lefebre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist

+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com