Bank of Korea chooses debt over disease

Today's Bank of Korea (BoK) decision to hike rates by 25bp came against the backdrop of a market completely split (actually fractionally leaning towards no change) as rapidly growing household debt was weighed against a worrying increase in Covid-19 infections. The BoK chose to focus on debt rather than disease in the end.

Source: Shutterstock

0.75%

7-day repo rate

up from 0.5%

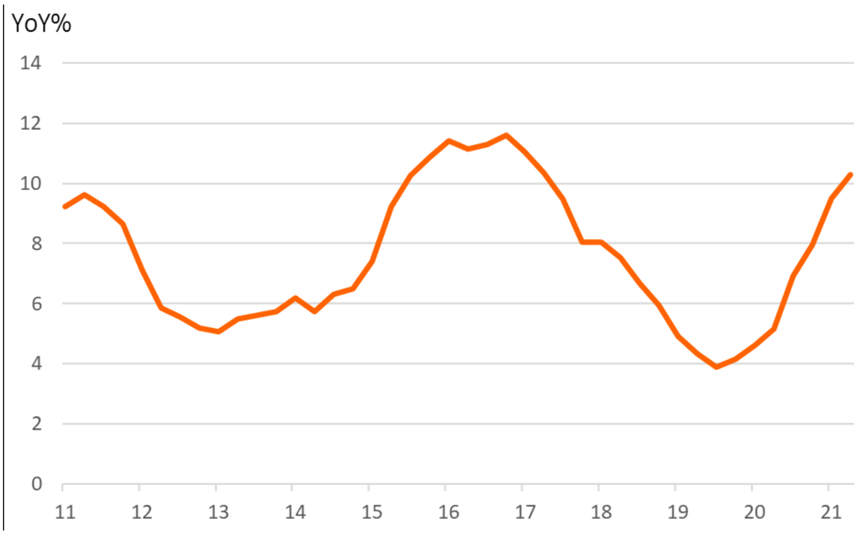
Higher than expected

Rates rise, can they do more before year-end? Probably...

The Bank of Korea decided after all to hike rates by 0.25% to 0.75%, making them the first mover in Asia of the countries we cover, and clearly not daunted by the earlier decision by the RBNZ to leave rates on hold due to rising Covid cases.

One thing that may have tipped the balance in this decision was the release of more household debt data earlier in the week. The rise in household debt has been a source of government and BoK concern for a considerable time now, but Covid has prevented any countermeasures to offset this. Clearly, and despite the increase in daily Covid cases in Korea, which is hovering around 2000 again, the BoK felt that the time had come to act.

Household debt growth YoY%

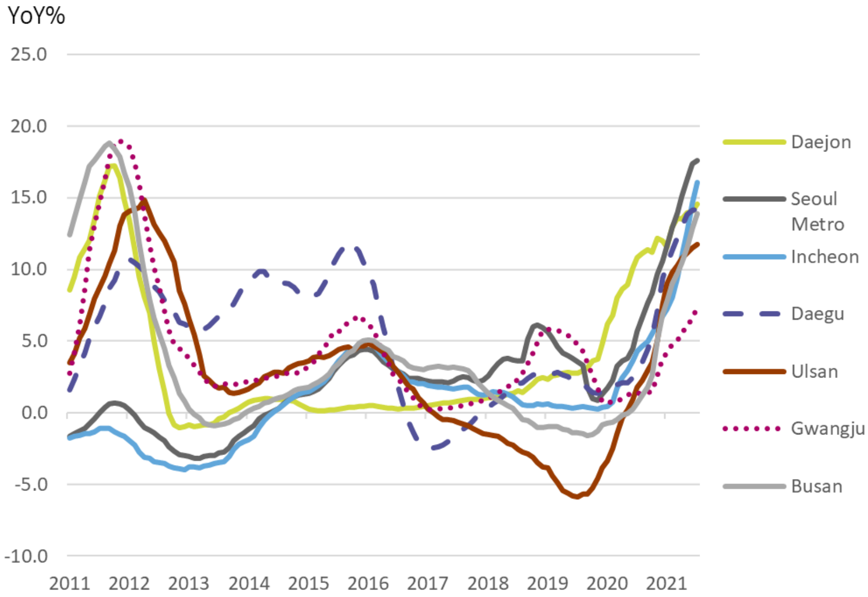


Source: CEIC

Debt is the flip side of a red-hot housing market

The flip-side of the rise in household debt is the housing market, where low rates have not been any barrier to rapidly rising prices across the country, with the national rate not far off 20%YoY. If there is ever a time when you can say that an asset is growing "too fast", this would be a good contender. The BoK will be attempting to soften house price growth, without kicking the legs from under the market. That's never an easy balancing act to pull off.

Residential property price increases



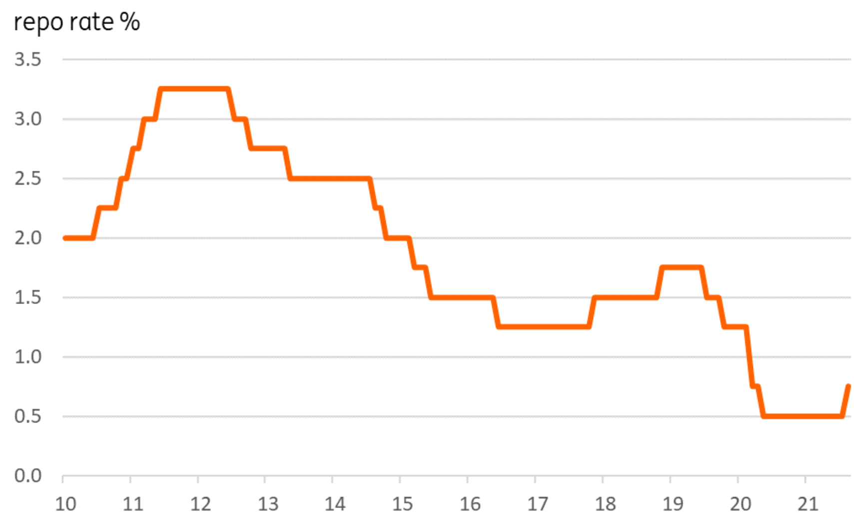
Source: CEIC

Where's the peak?

That takes us on neatly to the next question which is, "where do rates peak?". This is trickier, but the first thing to say is "lower than the last cycle", and that is a direct read across from the debt figures. With a higher household debt-to-income ratio, each rate hike will exact a greater squeeze on discretionary spending than in the cycle before, slowing credit growth to a more manageable rate earlier than in previous cycles.

The previous peak in policy rates was a mini-cycle in 2019, when rates got as high as 1.75%. I'd suggest that puts the peak in this cycle at no more than 1.5%, though it could reach it by the end of 2022 at this rate.

7-day repo rate



Source: CEIC

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