Bank of Korea expected to hike rates in May as inflation hits 13-year high

The consumer price index accelerated to 4.8% year-on-year in April – the highest since October 2008 – and is expected to hit 5% in the coming months. The Bank of Korea will respond to curb inflation in May, but the steps going forward will be heavier as the year-end approaches.

We expect the Bank of Korea to hike rates by 25bp in May, July and November.

4.8% CPI

Higher than expected

CPI is at its highest level in 13 years

Today's April CPI outcome of 4.8% year-on-year (vs 4.1% in March) was a surprise and was well above the market consensus of 4.4%. The monthly gain (0.7% month-on-month, seasonally-adjusted) has accelerated for five months in a row. Price gains in petroleum (+34.4%) and manufactured food (+7.2%) were most significant on the back of higher energy and food prices, yet the core CPI (excluding agricultural and oils) also rose 3.6% (vs 3.3% in March), the highest since December 2011.
CPI jumped to near 5% in April

Utilities are expected to rise further in the near future

Utilities such as electricity, gas, and water jumped to 6.8% in April (vs 2.9% in March) and are set to increase further throughout this year, to reflect the rise in raw material costs last winter. City gas price hikes are scheduled in May, July, and October while electricity rates will go up in October. The government has suppressed additional utility price increases so far, but given that global energy prices soared even higher this year, eventually, higher bills will be delivered at the end of this year or early next year. We expect higher utility costs to remain through 2023 and the lingering impact will keep CPI above the Bank of Korea's (BoK's) target for 2023.

Service prices increased more broadly in April

Service prices also rose firmly in April with the price gains more broadly based. Eating out prices stayed at an elevated 6.6% for the second month, taking a pause after rising sharply in March, while other personal services continued to increase. With the reopening of services in late March, labour-intensive services such as housekeeping, nursing, and apartment management expenses rose significantly, indicating some wage increases in low-skilled services. However, we expect the reopening effect to normalise within a few months, and we do not expect a labour shortage to come yet, so service sector price gains will be adjusted accordingly.
Gains in service prices are more broadly based

![Graph showing gains in service prices](source: CEIC)

Rents are key to watch in the coming months

While we expect the headline CPI to rise above 5% in 2Q and 3Q, we expect the monthly gain to moderate gradually in the coming months, mainly for two reasons:

1. The government’s fuel tax cut (expanding the tax cut by 30%), which started this month and will continue for the next three months, will help in slowing down fuel price gains

2. Rents are expected to subside thanks to a mortgage rate hike. Housing rents have shown some signs of moderation, falling to 2.0% (vs 2.1% in January) as mortgage rates for rental have increased since the beginning of the year.

Rental for housing prices have risen at a slower pace since the beginning of the year

![Graph showing rental for housing prices](source: CEIC)

Bank of Korea will respond in May

Based on higher-than-expected CPI and better-than-expected 1Q22 GDP results, we think that BoK will probably pay more attention to curbing inflation in the near future. Additionally, our US team now expects the Federal Reserve to deliver a 75bp hike in June after raising 50bp in May, with the terminal rate reaching 3.25% by the end of 2023. As BoK will not hold a policy decision
meeting in June, more aggressive Fed hikes increase the probability of the BoK’s rate action in May. Therefore, we expect BoK to announce a 25bp hike in May, July and November. Also, based on recent higher-than-expected price gains in underlying pipeline prices and Korean won depreciation, we are also substantially revising up our annual CPI forecasts to 4.6% (vs current 3.6%) in 2022 and to 3.0% (vs current 2.5%) in 2023.

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

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. ING forms part of ING Group (being for this purpose ING Group NV and its subsidiary and affiliated companies). The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is deemed authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. The nature and extent of consumer protections may differ from those for firms based in the UK. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority’s website. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.