

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

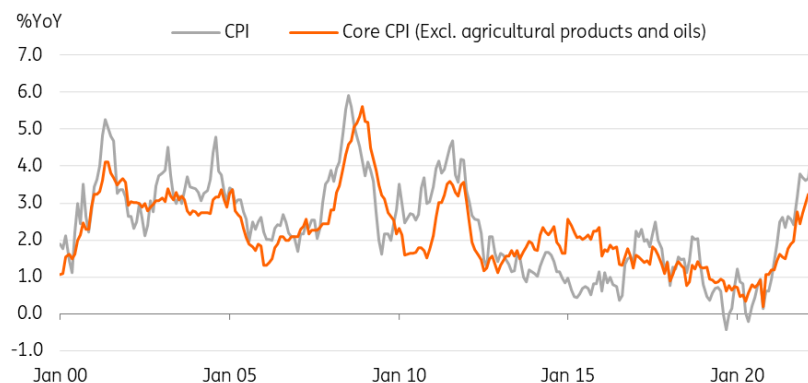
Higher than expected

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



Source: CEIC

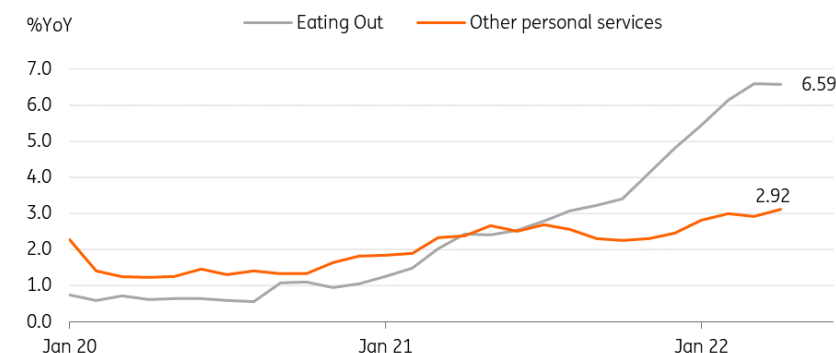
Utilities are expected to rise further in the near future

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



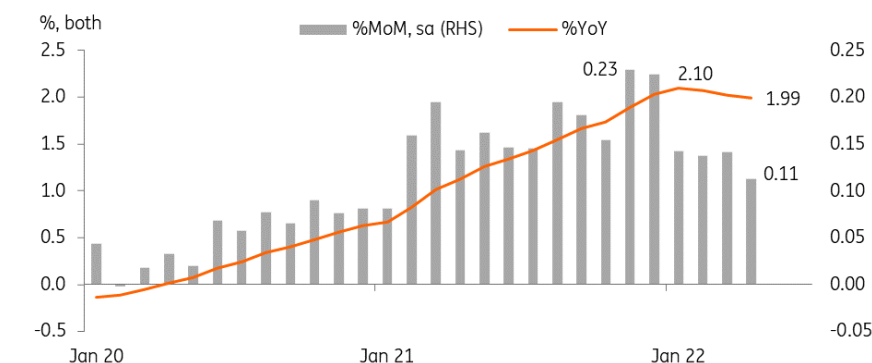
Source: CEIC

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



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.

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