

Bank of Korea hikes policy rate to 1.75% and forecasts much higher inflation for 2022

Bank of Korea (BoK) increased its policy rate to 1.75% to curb inflationary pressures while hinting at further rate hikes in the coming months. As inflation is expected to peak in the third quarter, we believe BoK will deliver two more rate hikes by the end of this year



Source: Shutterstock

1.75% Bank of Korea policy rate

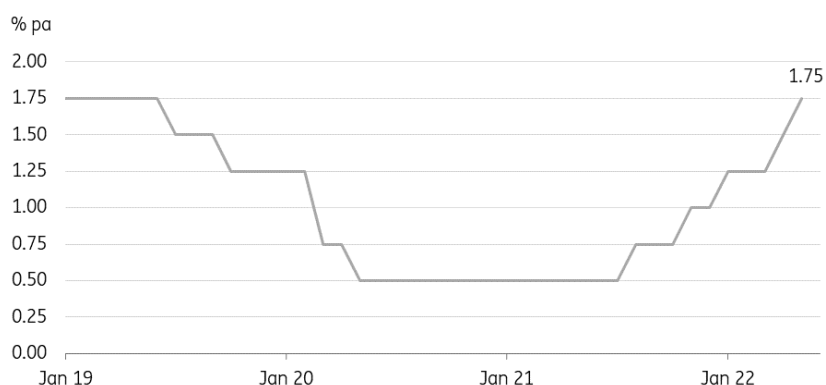
As expected

BoK is expected to raise rates by 50 bps this year as it prioritises inflation over growth

The Monetary Policy Committee (MPC) has unanimously decided to raise its policy rate by 0.25%, in line with the market consensus and ING's forecast. Governor Rhee Chang-yong made it clear that the central bank is more concerned about inflation than growth at this point, and the market

pricing on the year-end policy rate of 2.25-2.5% is “reasonable”, which indicates at least two more hikes by the end of this year.

BoK has delivered its fifth rate hike since the start of the pandemic



Source: Bank of Korea

BoK’s economic outlook signals more tightening in the future

The BoK released its latest economic outlook today. GDP forecasts for 2022 and 2023 have been revised down slightly to 2.7% (vs 3.0%) and 2.4% (vs 2.5%), respectively. Exports growth was downgraded as the global demand recovery is expected to slow down. China’s longer than expected lockdown and the ongoing war continue to dampen production activity in Korea. However, supportive fiscal policy and a strong domestic consumption recovery should support growth. We maintain the current GDP forecast at 2.8%, as we believe domestic demand, especially private consumption, will be stronger than what BoK projects.

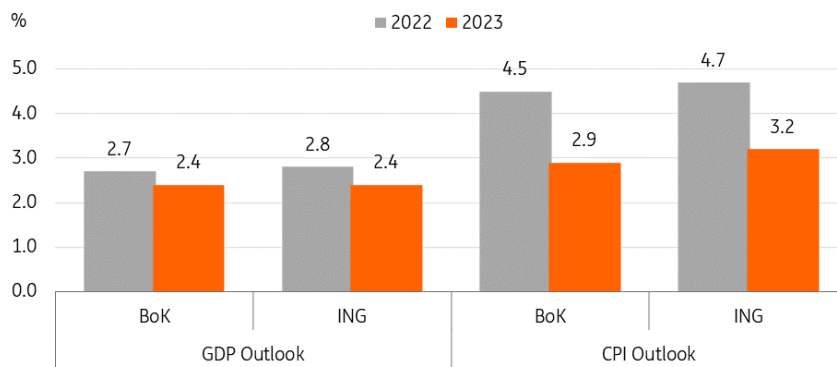
Regarding the inflation rate, the BoK made sharp upward revisions from 3.1% to 4.5% in 2022 and from 2.0% to 2.9% in 2023 as it assumed that commodity prices and both energy and food would remain relatively high until 2023. We expect a bit faster CPI growth than the BoK’s outlook with utility prices rising through the end of the year and higher wage growth next year, as wages in the public sector generally are pegged to the previous year’s CPI.

BoK revised up its CPI outlook sharply

| %YoY | As of Feb 22 | | As of May 22 | |
|------|--------------|-----|--------------|-----|
| | GDP | CPI | GDP | CPI |
| 2021 | 4.0 | 2.5 | 4.0 | 2.5 |
| 2022 | 3.0 | 3.1 | 2.7 | 4.5 |
| 2023 | 2.5 | 2.0 | 2.4 | 2.9 |

Source: Bank of Korea

Bank of Korea and ING's economic outlook

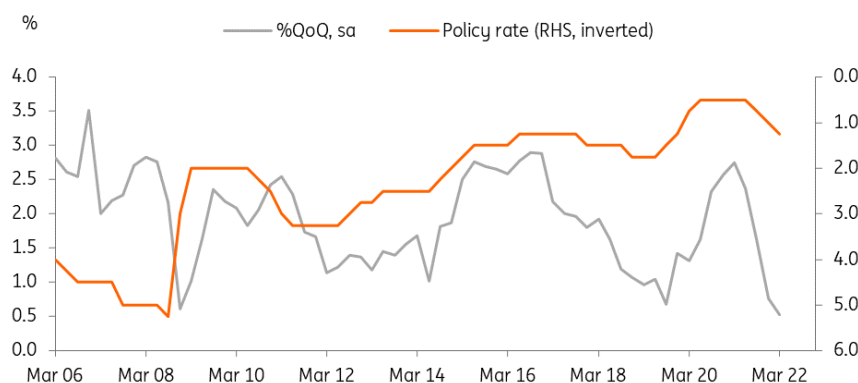


Source: Bank of Korea, ING

BoK will eventually slow down its rate hike pace by the end of this year

After today's MPC meeting, the market has been rapidly pricing in July and August rate hikes, and an additional hike in the fourth quarter. However, we'd like to check a few data points before we revise our BoK call – a 25bp hike each in July and November. First, CPI outcomes in May and June should be key to watch, and second, whether household credit growth will slow down. In fact, household credit growth slowed rapidly in 1Q22 mainly due to tight lending conditions. This is a key indicator that the BoK has been paying attention to while repeatedly expressing concerns about the fast pace of household leveraging. Although the government eased lending standards from 2Q, and thus credit growth reaccelerated again after April, the rebound is expected to be limited as the debt service burden for lenders increases. We think that even if CPI remains at an elevated level by the end of this year, the supply components of CPI stabilise then the BoK will slow its rate hike pace.

Household credit growth decelerated sharply in 1Q22 with tightening credit conditions



Source: Bank of Korea, ING

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