

Bank of Korea preview: Balancing sluggish domestic demand with curbing debt growth

Recent data points to sluggish domestic demand, while house prices in the Metropolitan Seoul area are likely to keep rising. This poses a challenge for future Bank of Korea (BoK) policy decisions, but for this week, the BoK is expected to remain on hold. Markets will be closely watching Governor Rhee's words for hints on the timing of a rate cut



100.8 Consumer sentiment index

Headline consumer sentiment index stayed above 100 for a third month

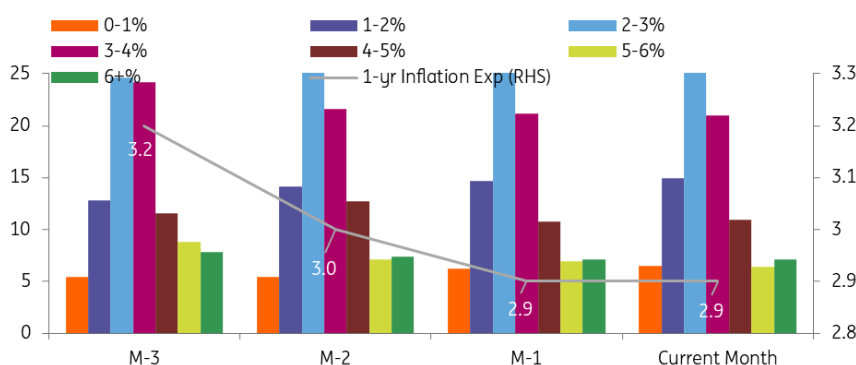
Although the headline index of the August consumer sentiment index remained above 100 (100.8 down from 103.6) all six sub-components declined. Indices for household income and spending showed the largest declines. Of the spending plans, eating out and travel spending dropped the most. Household consumption was already in contraction in the 2nd quarter and the findings suggest that the contraction will deepen this quarter.

On the other hand, expectations for house prices gained from a recent low of 92 in February to 118, the highest since November 2021. Despite rising mortgage rates and tighter lending conditions, this hasn't yet dampened consumers' high hopes for the housing market. The government plans to implement a stressed-debt-service ratio (DSR) programme from September, and potential homebuyers are believed to be rushing to buy homes before mortgage conditions tighten.

Inflation expectations stayed at 2.9% for a second month

Inflation expectations, which is closely monitored by the Bank of Korea, remained at 2.9% for the second month in a row. With inflation and expectations broadly trending lower, in line with the Bank of Korea's outlook, the policy focus of the Bank of Korea may shift from inflation to financial stability and growth. We think the government is going to extend the tax fuel cut programme in September. With government support, inflation should ease quite meaningfully to below 2% from September - mainly due to a high base last year.

Inflation expectations are trending down



Source: CEIC

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We have been arguing for some time that the Bank of Korea will struggle to decide the direction and timing of monetary policy between household debt and slowing economic growth. We expect household debt growth to accelerate in the coming months despite the Bank of Korea's tight monetary policy. Between sluggish consumption and curbing debt growth, the BoK's interest rate decision will become more difficult.

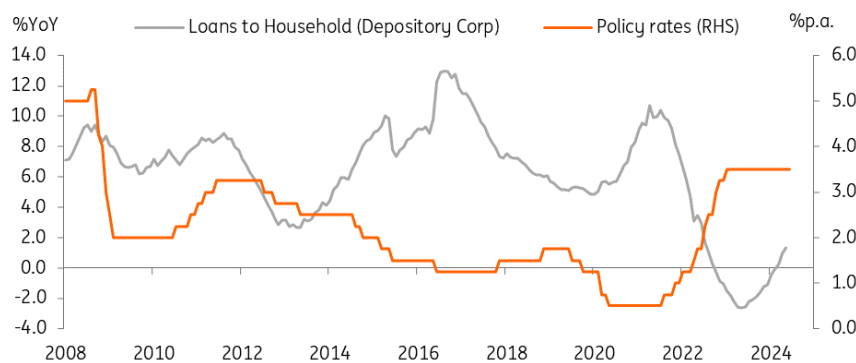
At the August meeting, financial market stability is likely to be the main focus, so the BoK is expected to keep policy rates unchanged at 3.5%, but we believe the overall policy stance among

board members has likely shifted towards easing compared to the past. A minority vote is possible, and this could make it more difficult for the BoK to manage market sentiment amid accelerating household debt growth.

The key is that signalling easing at this point could increase the risk of the market over-pricing a rate cut and stimulating debt growth and house prices. Consequently, the post-meeting press conference will be closely watched to see what the BoK thinks and communicates to the market about the recent rise in household debt and house prices.

We believe that the household debt problem cannot be controlled by the BoK's monetary policy alone, and policy coordination with the government is necessary. That's why we believe that if the government's housing policy and mortgage lending conditions tighten again from September, then the BoK is likely to pivot its policy stance toward easing in response to slower inflation and growth in 4Q24, as early as October.

Recent pick up in household debt should be a concern for the BoK



Source: CEIC

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