

## Bank of Korea puts brakes on rate hike but keeps hawkish tilt

The BoK's "hold" decision was widely expected. But one dissenting vote, Governor Rhee Chang-yong's hawkish comments, and growing uncertainty over inflation have hinted that the BoK will leave the door open for further rate hikes for now. We believe that the BoK may enter an easing cycle in the fourth quarter as inflation is expected to fall to the 2% range



**3.50%** Policy rates

As expected

### The Bank of Korea stays put for the first time since April 2022

It was not surprising that the BoK left its key interest rate unchanged at 3.5%, ending a streak of

rate increases at each policy meeting since April 2022. But the BoK stressed that the rate hike cycle may not be over yet. Board members were divided over terminal rates, with five members open to 3.75% while one remains at 3.50%. In our view, the BoK is taking a breather until the next decision in April to see how the accumulated interest rate hikes will affect inflation in the coming months and how the Fed's rate action will change the dynamics of domestic inflation.

The BoK expects headline CPI to slow to the 4% level from March and fall to the 3% level by the end of the year. Governor Rhee emphasised that if future inflation trends match the BoK's current forecast path, the BoK doesn't need to tighten its policy rate further, but uncertainties surrounding global commodity prices remain high, so it needs to be flexible in future policymaking.

## BoK trimmed its GDP and CPI forecasts for 2023

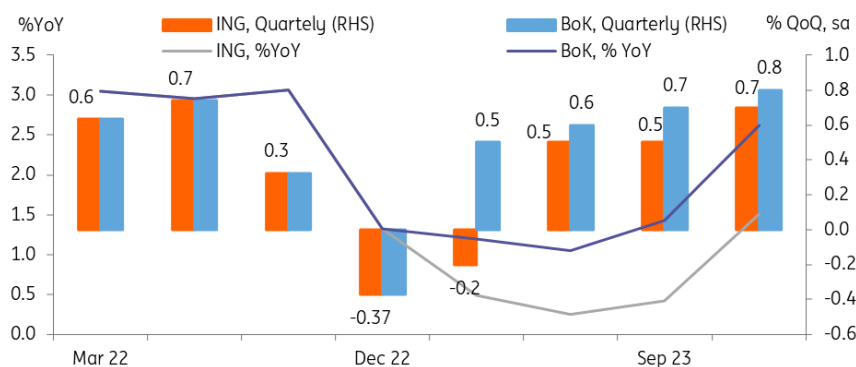
In our view, the BoK's relatively optimistic growth outlook was more surprising than the decision to hold the policy rate itself. The BoK did revise down its 2023 GDP forecast from 1.7% year-on-year (November forecast) to 1.6% but this is because the lower-than-expected fourth-quarter GDP dragged down annual growth in 2023. Looking at the updated GDP forecast, the BoK hasn't significantly changed its sequential trend of GDP growth from the November outlook.

This is quite different to the market consensus which has already revised down its GDP forecast meaningfully from the mid-1% to low-1% level. Also, the newly updated GDP forecast is substantially higher than ING's growth forecast of 0.6%. We think the BoK's optimistic view on growth is due to better expectations on improved external conditions, which will boost Korea's exports, in the second half of the year.

It is true that the US economy is showing robustness despite increasing borrowing costs, the mild weather has supported the EU economy over the winter, and China is recovering from Covid faster than expected.

However, the near-term outlook for exports is gloomy in our view. Based on the monthly exports data, including early February data, we expect the export contraction to deepen in the first quarter. The main export item, semiconductors, recorded an almost 50% drop in early February and inventory adjustment will likely progress slower than expected, which means that the semiconductor cycle will not provide much support to Korea's exports and investments. Also, the product cycle is not heavily driven by China's own economy, but more by global demand. With uncertainty regarding the Federal Reserve's rate hikes and dissipating pent-up demand on global IT investment, we believe that the negative impact on exports should be larger and longer than expected. Given growing tensions regarding tech trade between the US and China, Korean chip makers will probably face a difficult situation.

## GDP outlook: ING vs BoK



Source: BoK, ING estimates

In the case of inflation, the BoK cut its 2023 CPI forecast from 3.6% to 3.5% but noted high uncertainty surrounding the outlook. We agree with the BoK's concerns about the upside risk that global commodity prices could rise sharply depending on the geopolitical situation and the reopening of China. But we expect the slowing inflation trend to continue at least in the near term, as the pressure on pipeline prices has cooled over the past six months. In addition, utility bills and public service prices, which were the main cause of the recent inflation pick-up, are also expected to subside for the time being due to the efforts of the central government. Thus, we expect the headline CPI to slow to the 2% level in the third quarter.

## BoK watch

The BoK today dismissed expectations of a rate cut, reiterating its hawkish monetary policy stance, and highlighting uncertainties in future price paths, but we still expect the BoK to carry out a rate cut within the year.

We initially thought the BoK would start a rate cut cycle in the third quarter but considering the Fed's terminal rate could go beyond 5.0% in the second quarter, we are revising our BoK policy outlook accordingly, postponing the first rate cut to the fourth quarter of 2023.

We expect another sluggish GDP growth rate (-0.2% quarter-on-quarter, seasonally adjusted) in the current quarter based on weak exports and forward-looking investment data. We maintain our view that the weak start to the year will weigh down annual growth to the sub-1% level. Also, the government will continue to make efforts to stabilise near-term inflation, by providing energy vouchers to low-income households and by delaying further utility fee hikes to the second half of the year. If necessary, the government can extend its tax benefit programmes for energy and consumption. Thus, we expect inflation to slow down to the 2% level in the second half of the year. If we are right about the GDP and CPI forecast, then we think the BoK may begin its rate cut cycle in the fourth quarter of the year.

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