

Bank of Korea raises rates

The Bank of Korea raised the policy 7-day repo rate 25bp to 1.0%, in line with expectations following a strong steer at the last meeting when rates were left unchanged. Attention turns now to the cues for 2022 and how much further rates will be raised this cycle



Source: Shutterstock

1.0% 7-Day repo rate
Up 25bp

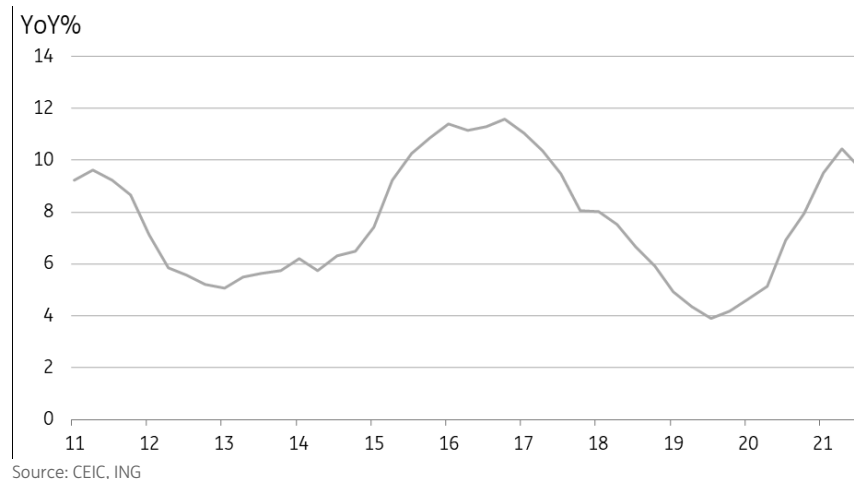
As expected

No surprises but what's next?

There was a unanimous expectation for the BoK to raise rates at this meeting. At the previous meeting when rates were left unchanged, BoK Governor Lee gave a fairly blunt signal that a hike in rates was likely at this meeting in the absence of any change in Korea's circumstances over the intervening month. One can argue about how much has changed since then, but clearly, no one thought things significantly different enough to warrant leaving rates alone again.

Much will now hang on Governor Lee's words at the press conference, but accompanying the rate decision, the statement noted that inflation would be higher than expected this year at 2.3%, and 2% in 2022. This still seems on the low side to us. Inflation should rise again with the release of November CPI data next week, which is likely to show inflation rising to 3.5%YoY up from 3.2% currently. Without a big correction in December's data, full-year 2021 inflation should manage 2.4%. And though it should drift lower through 2022, we see it averaging above the BoK's forecasts at more like 2.3% for the full year.

Credit to households YoY%



Some signs that excesses are diminishing

Despite our expectations for more inflation than the BoK is anticipating, there is little in the price data to suggest the same sort of persistence in prices, or development of a wage-price spiral that some may argue is happening in the US. And though the BoK's work is probably not yet done, we don't believe that it will need to raise rates much further this cycle.

Trying to pin down a neutral rate for nominal policy rates is a bit like trying to pin a tail on to a moving target. The neutral rate rises as the recovery is ongoing. The question we need to ask is, at what point will rising rates and the recovering economy come into a state where rates are neither stimulating nor depressing activity.

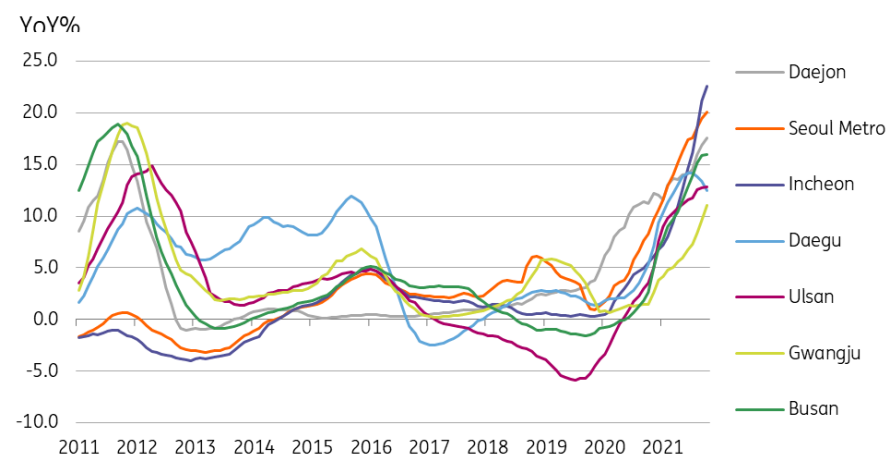
One important factor in this calculation is the very high level of household debt in South Korea. At not much less than 200% of household incomes, household debt is high by any comparison, international or historical. It is also clearly a factor underlying the very rapid growth in residential property prices in Korea - something that has alarmed members of the BoK and Korean government at times. Debt-service costs have already risen to about 13% of household incomes, and today's rate increase will take them higher still. And they are already higher than at any time this millennium - so they should start to bite soon.

Household credit growth is already showing some tentative signs of slowing down, though the annual growth rate remains uncomfortably high. And though it is very early days there are also signs that annual house price growth may be starting to peak out in some locations.

Finding the right level of rates to slowly bring these excesses back into a manageable range isn't an easy task, but a slow addition of a further 50bp accompanied by a signal that this might be the

end could deliver about the right mix, give or take the odd 25bp here or there. We see a peak for rates at 1.5%, only 50bp higher than today's level. The timing is harder to call. It may not come through fully until 2023.

Korean residential house prices YoY%



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