Bank of Korea leaves rates unchanged but leaves the door open for a rate cut

As widely expected, the Bank of Korea (BoK) kept interest rates on hold today, but there was not the dissent that we were looking for. This makes it even clearer that the BoK is in no hurry to cut rates. The focus is more on financial market stabiliy from now on. We continue to believe that an October rate cut is more likely than an August cut

The Bank of Korea is caught between a weak currency and weak growth

Source: Shutterstock

3.5%

BoK base rate

Held for 12 consecutive meetings

As expected

The BoK mulls rate cut timing while assessing inflation and financial market stability

The BoK's statement signalled a dovish shift in their policy stance, noting that they would review the timing of a rate cut if economic and financial conditions supported it in the future. The BoK is evidently more confident than it was that inflation will move towards their 2% target.

Concerns about upside risks to inflation were removed from the statement and the inflation assessment has also changed slightly. The BoK now thinks that headline inflation is likely to miss the current BoK outlook of 2.6%, but thinks that core inflation will meet the 2.2% outlook.

On growth, the BoK acknowledged the slowdown in domestic growth, but it seems that stronger-than-expected exports should offset weaker domestic growth so the growth path remains in line with the current outlook of 2.5%.

Governor Rhee sounded less dovish than the statement portrayed

Governor Rhee was reluctant to comment on the timing of rate cuts and expressed discomfort with the recent significant decline in market interest rates as bets on a rate cut by the BoK intensified. However, the number of members who said the central bank should leave open the possibility of a rate cut in the next three months increased to two from one at the last meeting. And given the confidence in the slowdown in inflation, the market's view on rate cuts is likely to strengthen for now.

We thought it was interesting that the BoK's focus has shifted from inflation to financial market stability. Governor Rhee acknowledged that the recent pick up in household debt and housing prices has been faster than the BoK had expected and noted that uncertainty surrounding the FX market could hurt the economy.

In our view, the issues of household debt and the property market need to be addressed jointly with government measures, not just monetary policy. However, this could still be a factor that delays the BoK's decision to cut rates. Inflation has been on a downward trend in recent months, but the price of city gas and some public services prices are set to rise in 3Q24. Moreover, inflation expectations remain at 3.0%. Despite the scheduled price hikes, inflation is expected to ease to a sub-2% level from August, mostly due to base effects. The market is split on the timing of the first cut between August and October. We are leaning towards an October cut rather than an August cut.

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