Bank of Korea still eyeing hikes later this year

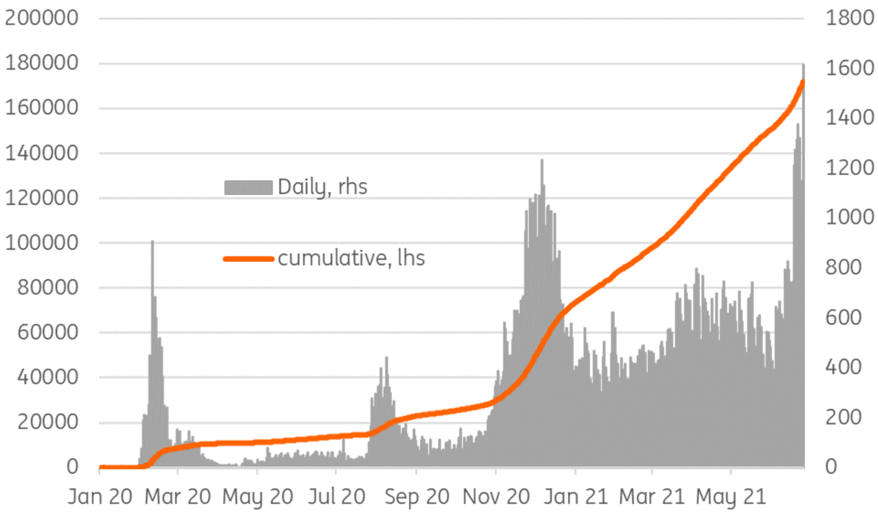
Even though daily Covid-19 cases in South Korea have been edging higher in recent weeks, the message from the Bank of Korea today, as they left policy rates unchanged at 0.5%, was that they were still looking at removing some accommodation before the end of this year

Source: Shutterstock

Hawkish tone retained, despite Covid-19 case increase

In recent weeks, the daily case numbers of Covid-19 in South Korea have edged up to around 1,600. This isn't high by global standards, but it is relatively high for Korea, especially given the still relatively low level of vaccination. That leaves Korea's population still vulnerable to some of the new more infectious variants, as these seem to require more than one jab before a significant degree of protection is acquired. For Korea, that means there is still a long way to go.

Korea Covid-19 daily and cumulative cases



Source: CEIC, ING

BoK acknowledge these risks, but intention is clear

At their policy meeting today, the Bank of Korea left the policy 7-day repo rate unchanged at 0.5%. But one of the board members dissented, preferring an immediate rate increase. We see this as the BoK laying down a clear marker of their intended direction, though with only one dissenter, this keeps their options open in terms of the timing. Two dissenters would have signalled a more imminent policy change. We are currently favouring the October policy meeting as the likely date of the first hike.

The key text in the statement, which was released along with the decision is "*The Board will maintain an accommodative stance of monetary policy as there remain uncertainties posed by the virus, although the Korean economy is expected to continue its recovery and inflation to remain at a high level for some time. In this process the Board will judge whether it is appropriate to adjust the degree of accommodation while thoroughly assessing developments related to COVID-19, changes in the pace of growth and inflation, and the risk of a buildup of financial imbalances".*

In the subsequent press conference, Governor Lee Ju-yeol noted that most members thought the BoK should focus on financial imbalance risks. He indicated that one or two hikes would not amount to a "tightening" which is both a comfort to the doves, as this suggests more of a semantic distinction about withdrawal of accommodation rather than a lengthy process of tightening. But he also sounded a note of caution that only one or two hikes might not be enough to rebalance leveraged investment (household mortgage borrowing for example) leaving it open that if housing and other markets continued to be frothy, the BoK would consider more tightening.

One way to interpret this is that the BoK is trying to send a signal to economic players that while the high level of household indebtedness could mean that monetary policy may be more effective with only one or two hikes, they are prepared to do more if necessary. This signalling suggests that their preference would be for the market to heed these warnings, allowing them to start to rebalance without needing to follow a more aggressive path. it also leaves open the risk that they will indeed do more if the economy is slow to rebalance. Korean Treasury bond yields have risen, and the KRW has appreciated slightly on these announcements.

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