Bank of Korea surprises market by keeping policy rate at 3%

After two consecutive rate cuts in the fourth quarter of last year, the Bank of Korea (BoK) opted for a wait-and-see stance today. Instead, the BoK expanded its special lending programme for small and medium-sized enterprises, which require the most policy support. We expect further easing soon as the economy struggles with slowing domestic growth

3.0% 7-day repo

Higher than expected

The Bank of Korea is ensuring it is still in the easing cycle

The Bank of Korea has decided to keep its policy rate unchanged at 3.0%, but all board members agree that more policy easing is needed to support the economy. Commenting on today's on-hold policy decision, the BoK explained that political uncertainty had caused the won to depreciate by about 30 won (out of a total of 70 won) over the past month, and the BoK was more focused on external conditions as political uncertainty lingered.

Regarding inflation and growth outlook, the BoK assessed that inflation is expected to remain within the Bank's inflation target range, but that upside risks have increased due to the weakening of the won and rising commodity prices. For the growth outlook, high-frequency data suggests a decline in consumption and investment, thus last year's fourth-quarter GDP is likely to be weaker than expected, possibly even lower than a 0.2% quarter-on-quarter growth. This will result in lowering both 2024 and 2025's full-year growth than the current forecast of 2.2% year-on-year and 1.9% respectively. The BoK will share an updated preliminary economic outlook before the official release in February, as current economic conditions have changed significantly.

Bank of Korea watch

Although the three-month forward guidance suggests a rate cut, the BoK's February cut is not guaranteed. It can be adjusted at any time if economic conditions shift. However, we expect the Bank of Korea to resume interest rate cuts in February after confirming economic activity data for December and January.

Even if the USDKRW climbs back, as long as the current political situation does not worsen and it is driven more by the global dollar strength, the BoK is likely to deliver a rate cut in February. After that, the BoK will keep a close eye on political developments, growth, inflation, and the won to gauge when to cut rates.

If economic activity recovers faster than sentiment indicators suggest, the BoK will probably slow down its rate cuts. But, we continue to think that a total of 100bp of rate cuts is plausible for 2025 for now.

Author

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com