Bank of Korea's hawkish pause extended on slowing inflation

As widely expected, the Bank of Korea decided to leave its policy rate at 3.50%. However, the BoK maintained its hawkish stance, seeing the risk of inflation reaccelerating to the 3% range over the coming months

The Bank of Korea in Seoul

3.5% 7-day repo rate

As expected

BoK still concerned about inflation

According to the Monetary Policy Decision statement, the BoK reiterated concerns about inflation despite the recent slowdown and estimated core inflation would exceed its current forecast of 3.5% in 2023, while its assessment of growth conditions has improved somewhat from the previous meeting. At the press conference, Governor Rhee Chang-Yong commented that the inflation path going foward is still unclear with several persisting upside risk factors, thus board members kept the door open to the possibility of a rate of 3.75%.

The lower-than-expected US inflation report will likely provide some relief for the BoK over its decision in the third quarter. The current situation is somewhat different from last year, when inflation exceeded 6%, forcing the BoK to chase the Federal Reserve's hikes. Given the current 2% range of inflation, we believe that the BoK will pay more attention to domestic economic factors such as inflation, financial market conditions, household debt, the Korean won, and growth conditions rather than the widening rate differential itself.

BoK watch

Based on the governor's comments and the MPC statement, we think the BoK will keep its hawkish stance at least until September. By then, the BoK will have a clearer picture of the inflation path as well as other major central banks' monetary policy. If we are right about inflation forecasts staying in the 2% range throughout the year, the BoK will make its first move to cut in the fourth quarter. With restrictive monetary conditions lasting more than a year, household consumption and investment are likely to be disrupted and signs of credit distortion will grow even more. However, high levels of household debt and the widening gap between the Fed will limit the pace of rate cuts.

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