BoK - rate cuts coming, why wait?

Although the Bank of Korea almost certainly won't cut rates tomorrow, the arguments for them to do so now, and not wait are overwhelming.

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We stand alone

We are alone amongst the consensus of forecasters looking for a rate cut from the Bank of Korea (BoK) tomorrow. We don't anticipate getting the call right. So why do it?

The consensus view is that the Bank of Korea will leave rates unchanged at the meeting, but show their leaning towards a cut at the next meeting (18 July) by having someone dissent from the no-change decision. This, the argument goes, will result in less shock to markets, less depreciation of the KRW and less of a chance of capital flight.

Let's pull that argument apart.

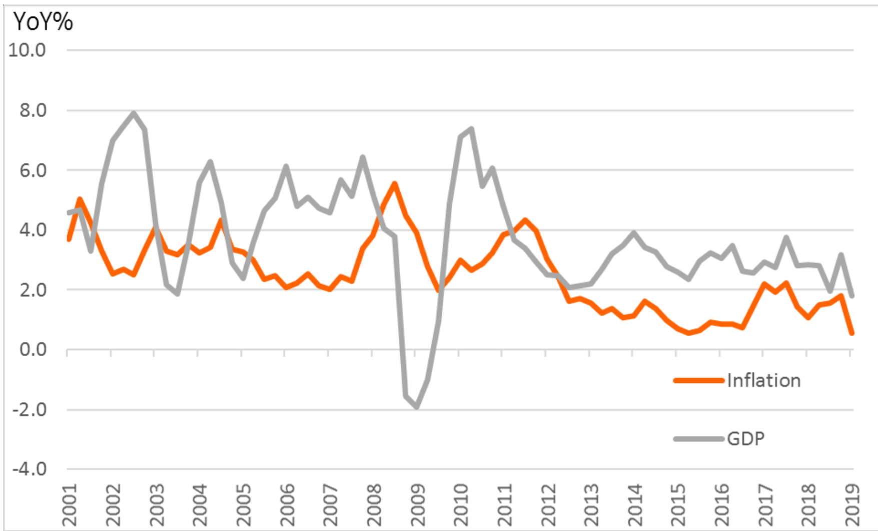
1. Is the economy **now** in good enough shape that there is no need for a monetary stimulus? Answer: No.
2. Is there a risk that by waiting, the Bank of Korea may ultimately end up having to do more easing in total? Answer: Yes
3. Is muting the impact of the rate decision on the currency to weaken its beneficial impact

through one of the more important transmission channels? Answer: Yes

On these and other counts, the economic backdrop would already clearly benefit from a rate cut, or more likely, a series of rate cuts. And if it is currently clear that this is the case, then any delay will only reduce the impact of any cuts when they do come, and increase the need for more easing in total.

So while I am not supposed to say what I think central banks *should* do with policy, it is pretty clear to me that the economy would perform more strongly if the BoK didn't drag their feet at tomorrow's meeting, and got on with whatever they are going to do anyway.

Korea: GDP and Inflation YoY%



Bygones are bygones

Probably one of the main factors weighing on the BoK is their past decisions. Back in November 2018, they hiked by 25bp, taking the 7-day repo rate to its current 1.75%. The economy wasn't in great shape then, with growth slowing and inflation fairly subdued. It is considerably worse now, with inflation only 0.6%YoY, and quite possibly heading for a second contraction when 2Q data are released on 25 July. That would be recession by almost any definition. And recession *now*, not only when the data is released at the end of July.

The argument for the November 2018 rate hike was, we felt at the time, an insufficient one for national monetary policy, resting as it did on regional sectoral issues - high Seoul house prices and high household debt. Focussed fiscal policy would have been a far more efficient way of tackling any perceived imbalance than national monetary policy.

But we all know how, having made a decision that with hindsight appears to have lacked a compelling justification, the temptation is to let it ride and hope that things go your way anyway. I do it with my forecasts. It comes with the job. Sometimes the data swing your way afterward and you can breathe a sigh of relief. In this instance, it hasn't. And the passage of time doesn't make that previous hiking decision any less relevant unless you only think that the direction of interest rates matters, not their level. That is almost certainly not the case in this instance, though on occasion we would concede that it could be.

So is a rate cut in July really less awkward than facing up to reality now? I personally don't believe it is, and I also don't accept that markets will punish a bolder move with a much weaker currency - maybe in the initial 24 hours that might be true. But I doubt it would be the case over a longer period. Capital flight arguments make little sense for a current account surplus economy like Korea anyway, and the stock market might even take a lift from a cut.

Stubbornly sticking to our ground

On the remote chance that we end up getting this call right, and we confess, this is vanishingly small, we will publish a very smug TOLD YOU SO note tomorrow.

Much more likely, we will have to take the walk of shame and join the consensus in calling the first cut for July, and at least one more cut before the year-end - maybe more. But when all is said and done, there is no point forecasting a rate decision *after* it has happened. So I know which side of the consensus fence I would rather sit on. It's not so bad being on your own.

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