Higher-than-expected inflation will push Bank of Korea into taking a 'big step' in July

South Korea's CPI inflation rate of 6% year-on-year in June has raised concern among policymakers about how aggressively they should be in tackling inflation while not stifling growth

Source: Shutterstock

6.0% Headline CPI

%YoY

Higher than expected

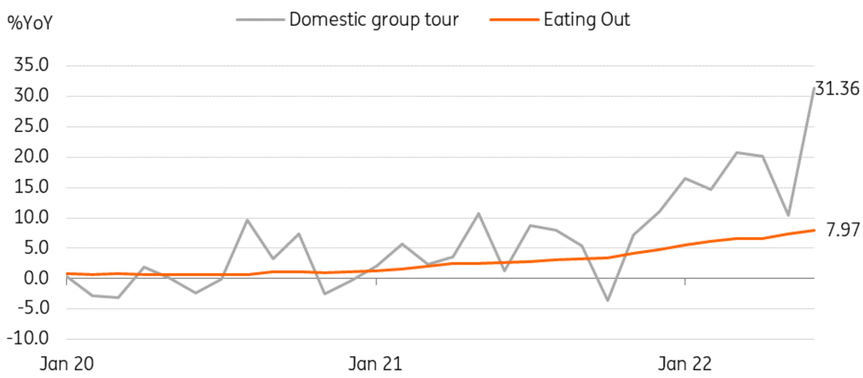
June CPI inflation accelerated to 6%YoY from 5.4% in May

Headline CPI inflation reached 6% for the first time since November 1998 with prices for both goods and services rising. July results were in line with ING's view but slightly beat the market consensus of 5.9%.

Looking at the detail, inflationary pressures built up not only in goods but also in services. Core CPI inflation, excluding agricultural products and oils, rose to 4.4% in June (vs 4.1% in May).

The reopening of the economy appears to be adding upward pressure to inflation. Prices for travel and eating out have already picked up sharply. Domestic group tour expenses soared by 31.4%YoY and eating out increased by 8%YoY. But at the same time, we are seeing some of the impact of earlier rate hikes as home rentals have stabilized compared to the beginning of this year.

Travel and eating-out prices on the rise



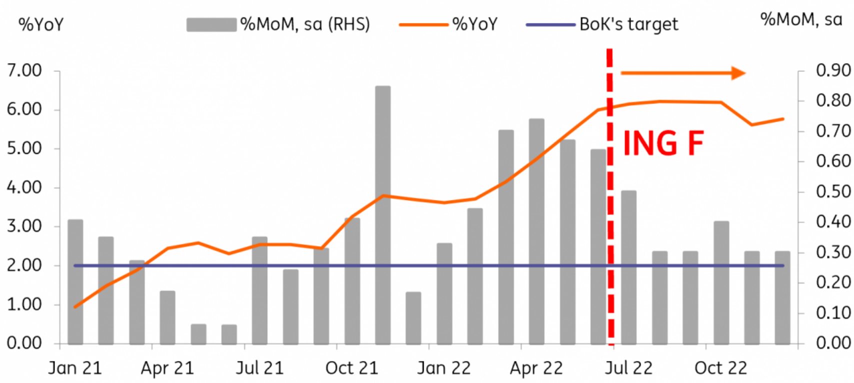
Source: CEIC

We expect inflation to rise further

There are several reasons why inflation will rise further in the coming months. 1) Electricity and gas prices have increased this month, 2) Fuel prices are expected to increase despite the expanded fuel tax cut from 30% to 37%, and 3) The summer vacation season begins from late July, which will likely pressure travel/leisure prices.

However, we expect monthly gains to decelerate, and the headline CPI will start to come down in 4Q22. On a seasonally adjusted month-on-month basis, consumer prices recorded a 0.64%MoM gain in June, slower than the 0.74% rate recorded for April.

We expect CPI to come down in 4Q22



Source: CEIC, ING forecast

The Bank of Korea's efforts to curb inflation will continue

Based on recently released data, we expect the BoK to deliver a 50bp hike in July, and then to revert to 25bp hikes in August and October. We still think that a total of 100bp of increases could stabilize inflation by the year-end. But, as tightening monetary conditions both home and abroad negatively impact next year's growth, we expect the BoK will enter an easing cycle by the end of 2023.

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