

Korea: BoK raised its policy rate by 25bp

As pipeline prices and inflation expectations have eased, the Bank of Korea returned to its normal 25bp pace of hiking today. Meanwhile, the recent surge in fresh food prices and the weak KRW are two major factors challenging the Bank of Korea's efforts to tame inflation.



2.5% 7-day repo rate
up 0.25%

As expected

The Bank of Korea decided unanimously to raise its policy rate by 25bp

There are some positive signs that the BoK's efforts are beginning to ease inflationary pressures. First of all, inflation expectations fell in August for the first time in eight months, while pipeline prices, such as import prices and producer prices, appear to be gradually fading from their peak. But the Bank of Korea (BoK) will remain on its current hiking path until disinflationary pressures become more prominent.

The statement accompanying the latest monetary policy decision clearly stated “*The Board sees continued rate hikes as warranted, as inflation is expected to remain high, substantially above the target level, despite the increase in economic downside risks and underlying high uncertainties surrounding domestic and external conditions.*” We expect the BoK to deliver another 25bp hike in October.

Another noteworthy point is that financial stability conditions such as capital flows have been added to future interest rate determination, which means that the KRW movement is also likely to be a key factor over the coming months.

Uncertainty on future inflation is growing

Food prices and currency weakness are two major risk factors. Fresh food prices have risen sharply due to the recent floods and prices are likely to rise further during the Chuseok holiday in September. Prices of some staple manufactured food items, such as ramen and bread, are scheduled to rise after the holiday. Meanwhile, the weaker KRW will likely partially offset the decline in commodity prices. Additionally, some local governments have started hearings about possible taxi fare increases sometime in the second half of the year. Therefore, the risk of rising inflation is still significant. At the press conference, Governor Rhee emphasized once again that the inflation-oriented policy will continue as long as inflation remains above 5%. If CPI inflation doesn't moderate by October and the KRW continues to weaken, then the possibility of an additional 25bp hike in November will grow.

BoK revised its macro outlook for 2022 and 2023

The GDP outlook for 2022 and 2023 has been downgraded as expected. The growth outlook for 2022 was trimmed to 2.6%YoY from the previous 2.7%, suggesting that the BoK does not expect growth to contract in the second half of the year. The GDP outlook for 2023 was revised down from 2.4% to 2.1%.

In our view, the latest GDP outlook for 2023 is too optimistic as the BoK expects quarterly growth to reaccelerate to above its potential growth rate. But given that global demand is expected to weaken over the coming quarters and fiscal policy is also expected to shift to normalization next year, this seems doubtful.

The BoK has also revised its inflation forecasts up to 5.2% (vs 4.5%) for 2022 and to 3.7% (vs 2.9%) for 2023. As next year's inflation is expected to exceed the Bank of Korea's inflation target of 2%, this opens up the possibility that interest rates may continue to rise next year if the forecast is correct.

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