Korea: consumer sentiment worsens while inflation expectations soar

The chances of a 50bp hike at the July MPC meeting have increased as inflation expectations rise to nearly 4%, while weak consumer sentiment indicates a slowdown in household spending and adds downside risk to the 3QGDP forecast

Source: Shutterstock

3.9% Inflation expectations

The BoK's consumer confidence index fell sharply to 96.4 in June (vs 102.6 in May), falling below the long-term average of 100 for the first time since Feb 2021

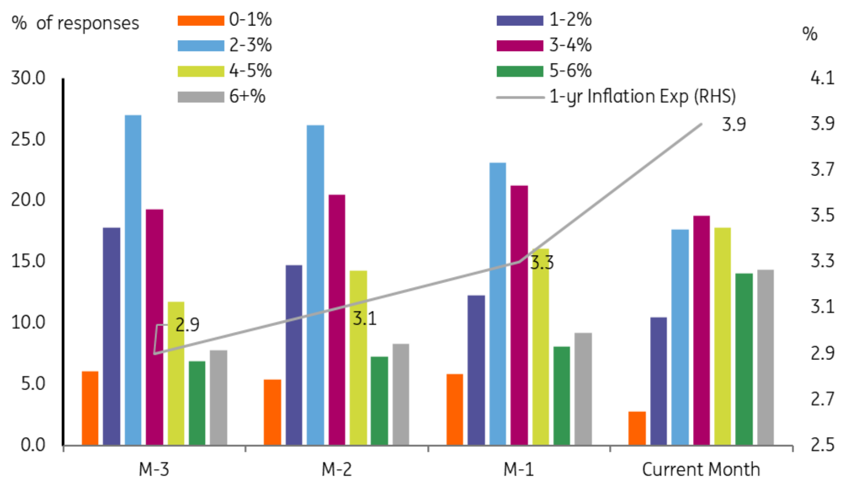
All six sub-components for the consumer sentiment index (CSI) were down, with indices for both the current assessment and expectations on the domestic economic situation falling significantly (-14pt and -15pt respectively). Spending plans remained above the neutral level, but fell by 2pt, the first decline in four months. Expectations for travel, eating out, and recreation were weak especially ahead of the summer vacation season, and probably reflect higher fuel and service prices. The pent-up reopening boost in 3Q may end up being smaller than expected.

We expected the CSI to slip this month, but not to this extent. The decline in confidence now puts downside risk to our GDP forecasts (0.7% q/q sa in 3Q22). The KOSPI has tumbled by more than 9%MTD while the KRW has broken through the 1300 level. Also, mortgage/lending rates have risen further. All these factors are probably hurting consumer sentiment.

Today's highlight should be inflation expectations, which rose to 3.9% in June (vs 3.3% in May)

Inflation expectations reached 3.9% in June (vs 3.3% in May), which could be a bigger concern for the Bank of Korea (BoK) than the decline in consumer confidence. The BoK has already expressed concern about self-fulfilling inflation increases, in which expected inflation rises first then actual inflation rises accordingly. Additionally, the rate of increase of inflation expectations is quite fast. A 0.6pt increase in a single month is the biggest rise in recent history.

Inflation expectations rose sharply in June



Source: CEIC

The probability of realizing the "big step" scenario of the BoK is increasing, but...

We think that today's CSI outcomes send a conflicting message to the BoK. Rising inflation expectations increase the likelihood that the Bank of Korea will hike by 50bp in July. But at the same time, the sharp decline in consumer sentiment will add to concern over an economic slowdown. A sharp rise in interest rates could exacerbate falling sentiment as well as actual future spending. The Korean economy is in a recovery phase, but it is heavily dependent on economic reopening and fiscal stimulus. As domestic demand is the main driver of growth, rapid rate hikes would curb the recovery in consumption. This could keep the BoK on its current path of raising rates in 25bp increments in July. We will check if the June CPI inflation rate exceeds 6% before committing to any forecast changes on our base case BoK call.

Author

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