South Korean inflation holds steady, but upside risks are increasing sharply

South Korea's headline CPI inflation remained at 2.0% year-on-year in February, but underlying inflationary pressures increased as core prices picked up. With oil climbing and the KRW weakening again, the economy faces greater inflation risks than previously forecast

2.0% YoY

Consumer price inflation

Core inflation excluding food and energy rose 2.3%

Lower than expected

Government efforts to stabilize fresh food prices kept the headline inflation to steady

Despite the Lunar New Year holiday, South Korean inflation was unchanged at 2.0% year-on-year in February. Fresh food prices fell 2.7% due to government price-stabilisation measures, and petroleum prices declined 2.4%. Yet firmer service prices -- up 2.6% -- indicate that underlying price pressures remain intact. Public service rose slightly by 1.6%, while private services rose more significantly by 3.5**%.** We believe that the government is tightly controlling public service fees.

Meanwhile, holiday-related travel and leisure prices have risen more meaningfully.

Looking ahead, considerable risks are skewed to the upside

Higher global oil prices amid the Strait of Hormuz closure have started to push up gasoline prices at the pump. According to OPINET daily information, gasoline prices rose an average 8.35% nationwide during the first five days of March.

Furthermore, geopolitical instability frequently negatively impacts the KRW. Earlier this week, the USDKRW briefly reached 1,500 before stabilising at 1,460 and now sits close to 1,473. Fallout from events in the Middle East could drive up both fuel prices and general import costs. Fuel comprises 4.3% of the total CPI basket. A sustained 10% increase in oil prices over a one-month period is projected to raise the CPI by approximately 0.4 percentage points. But ripple effects from a weak KRW should add more pass-through price pressure on other products.

Meanwhile, we expect the government and companies to absorb some of the shocks. The fuel subsidy tax could be the first lever the government uses. There have been quite strong verbal government interventions concerning petroleum companies. The government is likely to investigate if there's evidence of price collusion. It's also considering introducing a "price cap system". For other utilities, power bills haven't risen for more than a year. We expect utility prices to be on hold until the geopolitical risks dissipate.

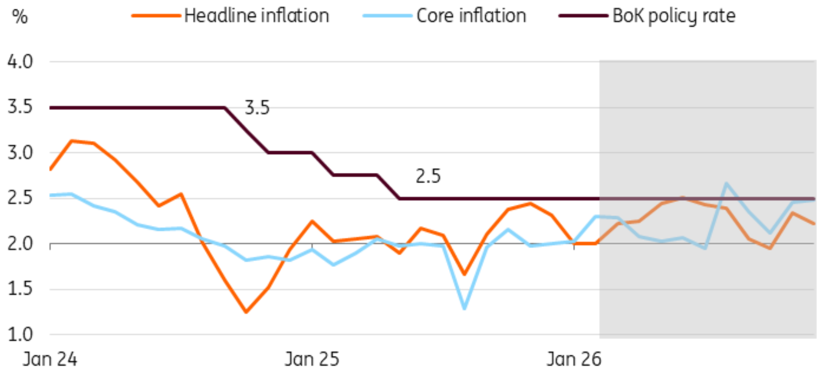
Taking all these factors into consideration, the projected overall impact is expected to increase by 0.2 to 0.4 percentage points in the forthcoming months.

Our CPI forecast for 2026 has been updated from 2.0% YoY to 2.2%, reflecting recent developments in oil prices and the Korean won.

The Bank of Korea will stay patient as expected higher inflation is largely caused by supply-side factors

We anticipate the Bank of Korea will maintain the current neutral policy stance to support the recovery in domestic demand. While inflation risks are clearly present, the BoK will maintain its current monetary policy stance unless recent market volatility undermines the fundamental drivers of growth. The greatest risks to the Korean economy stem from geopolitical uncertainties and the potential for rising oil prices to dampen AI investment. Exports are expected to remain robust, though recently released data indicates domestic demand conditions remain weak. We believe the BoK will focus on domestic demand recovery. We keep our BoK view of holding its policy rate at 2.5% throughout 2026.

The BoK s likely to keep its policy rate unchanged despite above 2% inflation



Source: CEIC, ING estimates

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