

Korea's faster-than-expected inflation will worry the central bank

Headline inflation accelerated more than expected in September and the risk of an uptick in the coming months is rising. The Bank of Korea will maintain its hawkish tilt through the second quarter of next year as inflation continues to hit the 3% range amid growing concerns over growth



The Bank of Korea in Seoul

3.7%

Consumer price index

% YoY

Higher than expected

Consumer prices rose mainly due to higher food and energy prices

Headline inflation rose 3.7% year-on-year in September (vs 3.4% in August, 3.5% market)

consensus) while core inflation excluding food and energy stayed at 3.3% for a third month.

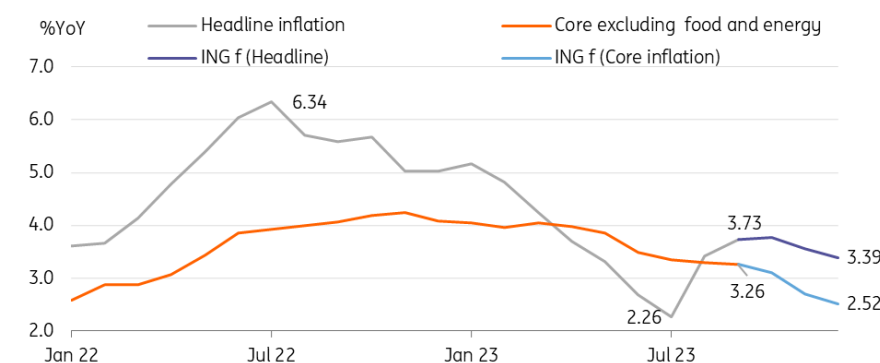
Fresh food prices jumped 6.4% (vs 5.6% in August), probably boosted by poor harvesting which coincided with the Chuseok holiday. Utility prices, such as electricity, water and gas, rose 19.1% although they have decelerated from the peak of 25.9% in June mainly due to a high base last year. This month's upside surprise mainly came from supply-side pressures as service prices continued to slow modestly to 2.9% from the recent peak of 4.0% in April. Commodity prices gained 1.4% month-on-month (not seasonally adjusted) while service prices fell -0.1% with rental and personal services down.

Inflation outlook

Headline inflation is expected to hover around the 3% range by the end of this year, higher than the BoK's current outlook. The recent rise in global commodity prices, the weak Korean won, and the increase in dairy and public transportation charges starting in October will put more upside pressures on inflation over the next few months. However, we expect service prices to decelerate modestly, mainly led by falling rental prices. The Bank of Korea will likely downplay its concerns over the recent supply-driven pick-up in inflation and focus more on the fact that core inflation will head down to the 2% range by year-end.

The Bank of Korea will likely keep its hawkish stance for an extended period until inflation subsides more meaningfully early next year. And, additional rate hikes are highly unlikely due to increased financial stress on businesses and households and ongoing instability in the property market.

Inflation is expected to stay above the 3% range until the end of this year



Source: CEIC, ING estimates

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