

Bank of Korea hikes rates by 50bp for first time ever

The BoK showed its strong policy commitment to price stability by raising rates 50bp but it is expected to adjust the pace of rate hikes from now on, as long as inflation does not rise significantly more than expected



2.25% BoK 7-Day Repo Rate

As expected

The BoK has unanimously decided to raise the policy rate to 2.25%

Although today's decision was in line with the market consensus, the larger-than-usual 50bp hike still came as a surprise to the market. We believe that the BoK is trying to send a strong signal to the market that it is willing to do what is necessary to meet its inflation target mandate. This was

confirmed by the MPC statement and governor's remarks at the press conference.

The BoK allocated a significant portion of its statement to explaining today's decision, making it clear that the 50bp hike is a preemptive response to avoid locking in high inflation. Also, it was clearly stated, "the Board sees continued rate hikes as warranted, as inflation is expected to run above the target level for a considerable time".

At the press conference, Governor Rhee Chang-yong mentioned that if inflation peaks in late 3Q or early 4Q, which is the BoK's base case scenario, a gradual 25bp increase would be appropriate and an additional one to two rate hikes wouldn't be considered tightening as the current rate of 2.25% is near the bottom range of the so-called neutral rate.

Regarding the recent weakness in the Korean won, Governor Rhee emphasised that it should be viewed in relative terms and that the strength of the US dollar is leading the way. While it is true that KRW has stayed on the weak side, it is probably because Japan and China, the two major central banks in the region, are going against the tide of the global tightening cycle. So, the KRW may have a rather negative spillover effect as Korea's trade volume with the two countries is relatively large.

We maintain our current view of two 25bp hikes in August and October to reach 2.75% by year-end

We agree with Governor Rhee's view on inflation in general. We expect headline inflation to continue rising for a couple more months from the current 6% and will probably start to slow in the fourth quarter. While the risk of rising global commodity prices still exists, we expect to see some impact from earlier rate hikes, which will decelerate the monthly growth of demand-side inflation over time.

However, compared to the BoK's view that next year's GDP will exceed the potential growth rate, we are somewhat pessimistic as it is expected to be lower than potential. Next year, both monetary and fiscal policy will become restrictive while external demand conditions are expected to worsen further. The government recently announced that it would legislate fiscal rules, stating that maintaining fiscal soundness at a good level over the medium term is a policy priority. That's why we believe that the BoK will enter an easing cycle by the end of next year.

Author

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss

arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.