

South Korea: On Hold but Rate Normalisation to Begin by Early 2Q10

As expected, the BoK maintained its benchmark base rate at record low of 2.0% for the tenth consecutive meeting today. However, BoK governor Lee Seongtae said that the interest rate level is “considerably” low given the improvement in the country’s growth outlook although uncertainties still remain. He hinted that planning is underway for an eventual exit from the loose monetary policy but said that it will not be an abrupt move, suggesting that the central bank will give ample warning to the market before hiking rates.

On inflation, the BoK foresees stable consumer price increase which means more attention will be on the asset price trajectory in the country. In November, the BoK widened its inflation target to 2.0%-4.0% for 2010-2012 period from 2.5%-3.5% in the two preceding years to allow for more flexibility in its monetary policy. We expect average headline consumer price inflation to be around 2.8% in 2010 which is similar to this year’s and monthly inflation rate will largely remain under 3%. On the property prices, BoK said concerns over the real estate ‘bubble’ appeared to have eased somewhat as price increase has slowed after the government introduced dampening measures in September. This will buy some time for the authorities to normalise interest rates. We are retaining our forecast for the interest rate normalisation process to start in the beginning of 2Q10 to bring about 125bps in total rate hike next year.

On the currency front, the BoK will likely check further KRW appreciation from here to prevent stalling the nascent recovery in exports. The current account surpluses are likely to remain supportive. USD/KRW will probably end the year at around 1,170 and trade sideways for most of 1Q10, ending the quarter at around 1,160 although a sooner interest rate normalisation in South Korea will likely have further upward pressure on the KRW.