

Macro Note

South Korea: BOK Raised Rates, Upped Inflation Forecast

Friday, 26 November 2021

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As widely expected, the Bank of Korea (BOK) raised its benchmark base rate by 25 bps to 1.00% on Thursday (25 Nov). This is the second rate increase following an earlier move in August, driven by concerns over financial imbalances and higher inflation. However, the rate decision was not unanimous with one member (out of seven) voting to hold interest rate.

Having hiked rates twice, Governor Lee Ju-yeol cited uncertainty over the next move but will not rule out another hike in 1Q22. The timing continues to be dependent on domestic economic conditions while Fed's normalisation trajectory would also be a factor. But by not committing to a timeline, the rate hike in November is seen as a dovish one. Adding to the uncertainty is Governor Lee's term that will end on 31 March 2022 as well as the presidential election on 9 March 2022.

The BOK raised its inflation forecast to 2.3% for 2021 (from 2.1%) and 2.0% for 2022 (from 1.5%), as it expects inflation to stay above its target of 2% in the short-term. The growth projection for 2021 and 2022 were maintained at 4.0% and 3.0% respectively. The central bank also issued its outlook for 2023 with GDP growth seen at 2.5% and CPI expected at 1.7%.

The benchmark rate is still below the neutral level. Barring a downturn in its economy, we continue to project the next BOK rate hike in 1Q22 that would have unwound the total 75 bps rate cut due to the COVID-19 pandemic. Further out, elevated inflation from demand recovery, higher raw material costs and wage growth may pressure the BOK to bring the base rate above 1.25%, the level before the pandemic.

The next meeting will be on 14 January 2022.

The key takeaways from the meeting:

- The BOK keeps its GDP growth forecast unchanged for 2021 and 2022 at 4.0% and 3.0% respectively. We expect a steady growth in 4Q21, following 4.0% y/y expansion in the first three quarters of 2021. We are in line with the BOK's forecasts for both 2021 and 2022. According to the central bank forecast, the output gap will close in 1H21.

Latest data in October showed exports remaining buoyant and the consumer confidence has improved further after earlier setback from its July COVID-19 outbreak. This was supported by employment gains and the disbursement of the cash handouts from the government's second supplementary budget. With 79% of its population fully vaccinated, the country eased social distancing rules earlier this month but the surge in local infections has raised concerns. Having said that, we continue to see room for further recovery in private consumption demand next year.

"Going forward, the improvement of private consumption is likely to strengthen, while exports and investment are expected to sustain favorable movements. GDP growth is projected to be around 4% in 2021 and around 3% in 2022, consistent with the forecast in August."

- Headline inflation in South Korea surged to 3.2% y/y in October from 2.5% y/y in September and the highest since February 2012. The upshot in inflation was within expectation as a result of the low base, higher oil prices and electricity price hike. This was also the 7th consecutive month that headline inflation has run above Bank of Korea's (BOK) 2% target.

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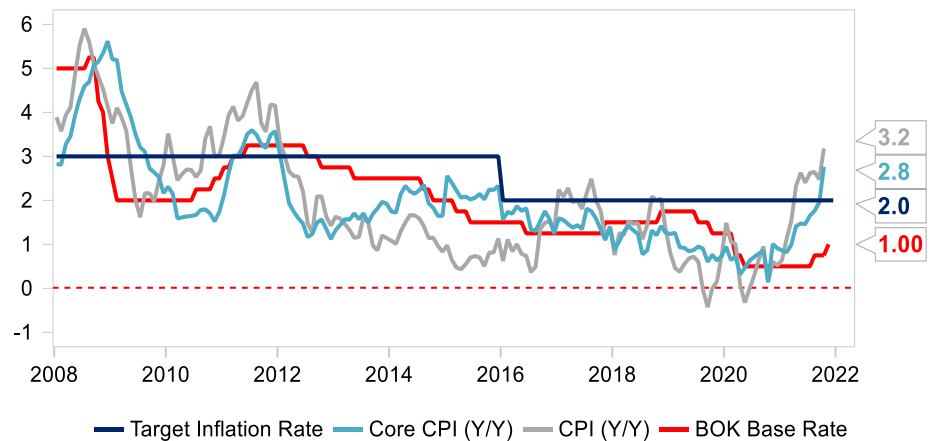
“The inflation expectations of the general public have increased to the upper-2% level. Looking ahead, it is forecast that consumer price inflation will run considerably above 2%, exceeding the path projected in August, and then decline gradually, running at around 2% for 2022 as a whole. Core inflation is forecast to increase to the upper-1% level.”

- Financial imbalances remain a big concern for the BOK but it noted that the burden on households will rise as interest rates are normalised. That may dampen the recovery in private consumption. Further rate increase will remain gradual.

“The amount of increase in household loans has lessened somewhat, and housing prices have continued to increase rapidly in all parts of the country.”

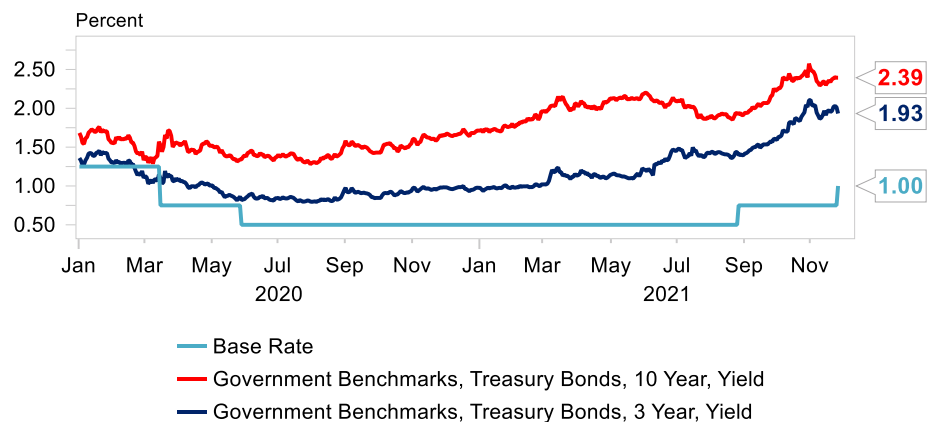
South Korea: BOK Raised Rates A Second Time In Nov

Source: Macrobond, UOB Global Economics & Markets Research



South Korea: KTB Yields Rise May Slow After Dovish Hike

Source: Macrobond, UOB Global Economics & Markets Research



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