Korea Watch

BoK review: Cautious view on inflation may prevent near-term easing

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GEM Economics
Asia | Korea

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Another widely expected hold; one member open to cut

The Bank of Korea (BoK) kept the policy rate unchanged at 3.5% on 22nd Feb, the nineth straight meeting since Feb 2023. The decision was widely expected and once again unanimous. This is also the first meeting for the new member Kunil Hwang. Compared to the Jan meeting, one member is now open to rate cut (pointing to slowing domestic consumption), while 5 members still in favor of holding rate even after 3 months.

Restrictive stance amid inflation and external conditions

In the statement and press conference after Feb meeting, the committee highlights the elevated uncertainties surrounding the macro environment, notably inflation and external conditions. As a result, the central bank sees the needs to keep restrictive stance for sufficiently long period.

On **inflation**, the committee acknowledges the recent disinflation trend, but are still not confident that inflation will converge to target level. Specifically, it keeps headline inflation forecast unchanged despite lower core inflation forecast (*see more on next page*), reflecting the temporarily higher agriculture prices and geopolitical risks (that affect commodity prices).

On **domestic economy**, the committee also maintained its GDP forecast for 2024. It sees an improving trend driven by strong exports, and global GDP growth maybe more favorable than expected. However, this is offset by weakness in private consumption and construction investment. In the property sector, although the statement addresses the lingering risks related to real estate project financing (PF), Governor Rhee stated in the press conference that considerable number of PF risks have been sorted out.

On **external conditions**, the committee highlights the higher global bond yields & USD due to weakening expectations of an early Fed cut. The central bank will continue to monitor major countries' policies and FX volatility. That said, in the press conference, he also stated that Korea monetary does not automatically follow US policy, and is not ruling out the possibility of cutting before the Fed.

Now expect easing stance in 2Q, but cuts from 3Q24

Despite the favorable inflation print in January, BoK still kept their 2024 headline CPI inflation forecast unchanged at 2.6% (same as Nov's projection), higher than the consensus (of 2.4%). It also states it is premature to be confident that inflation will converge on the target level. In our view, this suggests the BoK has a more cautious view on inflation, and it may take time for them to ease such concerns even with a favorable near-term inflation prints (Rhee also said it will have wait until May data to have a better idea of the policy direction). In addition, the weakening expectations of an early rate cut by the Fed may prompt the BoK to ease later than sooner.

All combined, we now see a higher chance that BoK will only deliver an easing stance in 2Q (e.g. more members open to cut and dissent vote/s in the MPC meetings in Apr-May), rather than an actual cut decision. We revise our BoK rate cut call to 2 cuts (25bp each in 3Q and 4Q) this year (from 3 cuts previously), followed by 2 more cuts in 1H25.

Unchanged forecasts for 2024 and 2025

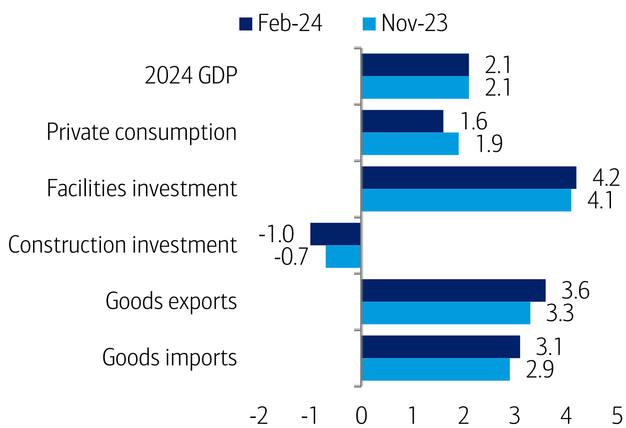
In the macro projection, the central bank maintains its headline growth and inflation forecasts unchanged compared to the Nov's projection.

On growth front, the BoK keeps headline GDP forecast unchanged at 2.1% in 2024 (vs our expectation of 2.3%), but with revision in different components. Private consumption growth is marked down to 1.6% from 1.9% previously, as well as construction investment (-1.0% vs -0.7% previously). On the other hand, goods export is revised up to 3.6% (vs 3.3% previously), while facility investment is also marked up by 0.1pp to 4.2%. With the higher export growth, the BoK also revises up the 2024 current account forecast (to USD52bn from USD49bn).

On inflation front, the central bank maintains the headline CPI forecast at 2.6%, versus our expectation of 2.3%. That said, inflation in 1H24 is slightly marked down to 2.9% (from 3.0% previously). Core CPI forecast is revised down to 2.2% (from 2.3% previously), reflecting the slow pace of consumption recovery, same as our projection. This reflects the central bank's view of higher commodity inflation in 2024.

Exhibit 1: BoK 2024 GDP forecast

The BoK kept headline GDP forecast unchanged in 2024, but slight revision in growth of components



Source: BoK

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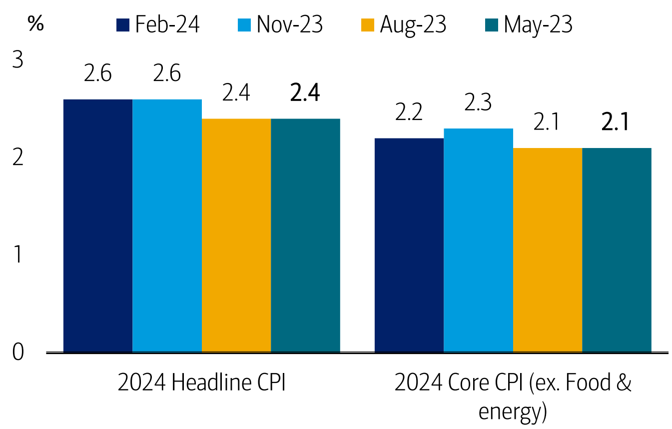
Exhibit 2: BoK 2024 CPI forecast

The BoK revised up both headline and core CPI forecasts



Source: BoK

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Exhibit 3: Monetary policy decision statement

The BoK says it is premature to be confident that inflation will converge on the target level

22-Feb-24	11-Jan-24
The Monetary Policy Board of the Bank of Korea decided today to leave the Base Rate unchanged at 3.50%	The Monetary Policy Board of the Bank of Korea decided today to leave the Base Rate unchanged at 3.50%
Global Economy	**Global Economy**
The currently available information suggests that global economic growth is projected to continue slowing, but it will be more favorable than expected. Inflation in major countries continues its trend of a slowdown, but it is expected to take a considerable period of time for that inflation to stabilize on the target level. In global financial markets, government bond yields have risen and the U.S. dollar has strengthened due to weakening expectations of an early policy rate cut by the U.S. Federal Reserve. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected by global oil prices and inflation trends, by monetary policy operations in major countries and their effects, and by developments in geopolitical risks.	The currently available information suggests that the trends of a slowdown in both global economic growth and in inflation have continued, driven by restrictive monetary policy stances being sustained in major countries. However, inflation in major countries still remains high, and it is expected to take a considerable period of time for that inflation to stabilize on the target level. In global financial markets, government bond yields have fallen and the U.S. dollar has slightly weakened, led by expectations of a pivot in the U.S. Federal Reserve's monetary policy stance. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected by global oil prices and inflation trends, by monetary policy operations in major countries and their effects, and by developments in geopolitical risks.
Domestic Economy	**Domestic Economy**
Domestic economic growth has continued to improve at a modest pace, mainly driven by exports. Labor market conditions have been generally favorable with a continued robust increase in the number of persons employed. Going forward, domestic economic growth is projected to maintain its improving trends with an ongoing increase in exports, despite the slow recovery of consumption and the sluggishness in construction investment. GDP growth for the year is expected to be 2.1%, which is consistent with the November forecast. However, there are high uncertainties regarding the outlook, which are related to the effects of monetary policy in major countries, the pace of improvement in the IT industry, and the impact of real estate project financing (PF) restructuring.	Domestic economic growth has continued to improve at a modest pace, mainly driven by exports. Labor market conditions have been generally favorable with a continued robust increase in the number of persons employed, while the unemployment rate has risen owing to temporary factors. Going forward, domestic economic growth is projected to maintain its improving trends with an ongoing increase in exports, although consumption and construction investment are expected to recover at a slow pace. GDP growth for the year is expected to be generally consistent with the November forecast of 2.1%. The future path of economic growth is likely to be affected by the effects of restrictive monetary policy stances being sustained at home and abroad, and by the degree of improvement in the IT industry.
Inflation Trend	**Inflation Trend**
Inflation has maintained its slowing trend. Consumer price inflation has fallen to 2.8% in January due to slower growth in the prices of personal services and processed food products. Core inflation (excluding changes in food and energy prices from the CPI) has slowed to 2.5%, and short-term inflation expectations among the general public have fallen to 3.0%. Looking ahead, it is forecast that consumer price inflation will temporarily rise slightly owing to increases in agricultural product prices, and then gradually fall again. Consumer price inflation for the year is projected to be 2.6%, which is consistent with the November forecast. Core inflation for the year is expected to be 2.2%, slightly lower than the November forecast of 2.3%, reflecting the slow pace of consumption recovery. The future path of inflation is likely to be affected by developments in geopolitical risks, by movements of global oil prices and domestic agricultural product prices, and by economic growth at home and abroad.	Consumer price inflation has fallen to 3.2% in December due to the continued decline in prices of petroleum products. Core inflation (excluding changes in food and energy prices from the CPI) and short-term inflation expectations among the general public have moderated to 2.8% and 3.2%, respectively. Looking ahead, inflation is projected to maintain its slowing trend, but the pace of slowdown is expected to moderate due to the effects of accumulated cost pressures. Consumer price inflation is likely to fluctuate at around 3% for some time and then gradually moderate, and it is expected to be generally consistent with the November forecast of 2.6% for the year. Core inflation is also forecast to maintain its modest slowdown, which is consistent with the path projected in November. The future path of inflation is subject to high uncertainties associated with movements of global oil prices and agricultural product prices, and with economic growth at home and abroad.
Financial Market Trend	**Financial Market Trend**
In financial and foreign exchange markets, long-term Korean Treasury bond yields and the Korean won to U.S. dollar exchange rate have risen, mainly affected by weakening expectations of an early policy rate cut by the U.S. Federal Reserve. Household loan growth has remained low due to an ongoing reduction in other loans, despite continued growth in housing-related loans. Housing prices have continued to decline across all parts of the country, and risks related to real estate project financing (PF) still remain.	In financial and foreign exchange markets, long-term Korean Treasury bond yields have fallen due to expectations of a pivot in monetary policy stances both at home and abroad. The Korean won to U.S. dollar exchange rate has fluctuated within a relatively narrow range. The extent of the increase in household loans has narrowed significantly due to a reduction in other loans, despite continued growth in housing-related loans. Housing prices have shifted to a decline across all parts of the country, and risks related to real estate project financing (PF) have heightened.
Monetary Policy Direction	**Monetary Policy Direction**
The Board will continue to conduct monetary policy in order to stabilize consumer price inflation at the target level over the medium-term horizon as it monitors economic growth, while paying attention to financial stability. While it is forecast that domestic economic growth will continue its improving trend and that inflation will maintain its slowing trend, it is premature to be confident that inflation will converge on the target level. Moreover, uncertainties surrounding domestic and external policy conditions are also judged to be high. The Board, therefore, will maintain a restrictive policy stance for a sufficiently long period of time until the Board is confident that inflation will converge on the target level. In this process, the Board will thoroughly assess the inflation slowdown, risks to financial stability and economic growth, household debt growth, monetary policy operations in major countries, and developments in geopolitical risks.	The Board will continue to conduct monetary policy in order to stabilize consumer price inflation at the target level over the medium-term horizon as it monitors economic growth, while paying attention to financial stability. While domestic economic growth is forecast to continue its improving trends, inflation still remains high and uncertainties regarding the outlook are also judged to be high. The Board, therefore, will maintain a restrictive policy stance for a sufficiently long period of time until the Board is confident that inflation will converge on the target level. In this process, the Board will thoroughly assess the inflation slowdown, risks to financial stability and economic growth, household debt growth, monetary policy operations in major countries, and developments in geopolitical risks.

Source: Bank of Korea, BofA Global Research

Note: "__" indicate new information versus the previous meeting.

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