Korea Watch

BoK review: A dovish shift in statement but hawkish tone in press conference

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GEM Economics
Asia | Korea

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BoK holds rate with a dovish shift in statement

The Bank of Korea (BoK) kept the policy rate unchanged at 3.5% on 11 Jan, the eighth straight meeting since Feb, and was widely expected. The decision was once again unanimous. Importantly, the central bank removes "need to raise the Base Rate further" in the latest statement, first time to signal a relatively dovish tone since the rate hike cycle. Also, 5 board members see current rate of 3.5% as peak, compared to only 2 members in the previous meeting.

Policy trajectory and domestic risks in focus

In the statement and press conference after the Jan meeting, the committee highlighted the downside pressures in growth and rising risks in the property sector, alongside uncertainties in inflation. Concerns on external risks are kept in the statement but not much mentioned in the press conference. Importantly, Governor Rhee mentioned very low chance of rate cut in the press conference.

On **domestic economy**, the committee still expects 2.1% growth in 2024 (same as November projection). Although domestic growth could maintain its improving trends with better exports, consumption and construction investment may only recover slowly. As Governor Rhee mentioned in the press conference, the biggest risk factor for growth currently is the China economy.

On **inflation**, the committee acknowledged the recent disinflation trend, but expects inflation to fluctuate at around 3% for some time. This is consistent with our forecasts, in which we expect headline CPI to move below 2.5% starting May. In addition to energy prices and growth factors, the BoK now thinks agricultural product price is also an important driver of headline inflation.

On **property sector**, the statement highlights rising risks related to real estate project financing (PF) and nascent decline in housing prices in all parts of the country. That said, such PF loan risks are being sorted out in orderly fashion, as Rhee said in the press conference. Rhee also readdressed that the mistake of fueling the property market again should be avoided. When asked about household debt, Rhee favors household debt to GDP ratio at below 90%.

On **policy rate trajectory**, Governor Rhee said it is difficult to cut rate for at least next six months, and the board finds it premature to talk about rate cut.

Expect 1st cut in 2Q24 despite hawkish press conference

Taken the decision, the dovish statement and hawkish press conference together, the central bank delivered a relatively balanced stance on future monetary policy path. Despite the relatively affirmative stance by Rhee, we still see rate decision to be determined by the mixture of domestic and external conditions. The slower consumption, rising PF risks, Fed potential cut amid gradual disinflation create a favorable environment for easier monetary policy, in our view. As such, we continue to expect the BoK to deliver 25bp cut per quarter starting May, and expect the terminal rate at 2.5% as of 1Q25.

Refer to important disclosures on page 4 to 5.

Exhibit 1: Monetary policy decision statement

The MPC removes "need to raise the Base Rate further" in the statement

11-Jan-24	30-Nov-23
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 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.	The currently available information suggests that both concerns about a further tightening by the U.S. Federal Reserve and geopolitical risks have been alleviated. However, global economic growth is projected to continue slowing, driven by a prolongation of restrictive monetary policy stances in major countries. Inflation in major countries still remains high, while continuing its slowdown, and core inflation is declining at a slow pace. In global financial markets, government bond yields in major countries have fallen significantly and the U.S. dollar has weakened considerably. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected by the movements of global oil prices and the global inflation slowdown, by monetary policy operations in major countries and their effects, and by developments in the Israel-Hamas conflict.
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, 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.	Domestic economic growth has continued to improve at a modest pace owing to the easing of sluggishness in exports. Labor market conditions have been generally favorable, as the scale of the increase in the number of persons employed has expanded and as the unemployment rate has remained low. Going forward, domestic economic growth is expected to maintain its improving trends with an ongoing recovery in exports. GDP growth for this year is forecast to be consistent with the August forecast of 1.4%. The growth rate is expected to pick up to 2.1% in 2024, though slightly lower than the August forecast of 2.2%, affected by a prolongation of restrictive monetary policy stances at home and abroad and by a slow pace of consumption recovery. In the economic outlook, uncertainties regarding the effects from a prolongation of restrictive monetary policy stances at home and abroad and developments in geopolitical risks are judged to be high.
Inflation Trend	**Inflation Trend**
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.	Consumer price inflation has risen to 3.8% in October due to the increase in the prices of agricultural products and energy. However, core inflation (excluding changes in food and energy prices from the CPI) has fallen to 3.2% in October. Short-term inflation expectations among the general public have risen slightly to 3.4%. Looking ahead, inflation is projected to maintain its underlying slowing trend owing to the weakening of demand-side pressures and to declines in the prices of global oil and agricultural products. However, it is forecast to run above the path projected in August, affected by cost pressures being higher than expected. Consumer price inflation will gradually moderate and will run at around 3% in the first half of 2024, and it is projected to be 3.6% in 2023 and 2.6% in 2024. (The August forecast was 3.5% and 2.4%, respectively.) Meanwhile, core inflation is forecast to maintain its modest slowdown, and is expected to be 3.5% in 2023 and 2.3% in 2024. (The August forecast was 3.4% and 2.1%, respectively.) The inflation path is likely to be affected by movements of global oil prices and exchange rates, and economic growth at home and abroad.
Financial Market Trend	**Financial Market Trend**
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.	In financial and foreign exchange markets, risk aversion has subsided on heightened expectations of an end to policy rate hikes by the U.S. Federal Reserve, while geopolitical risks have eased. Korean Treasury bond yields and the Korean won to U.S. dollar exchange rate have fallen significantly and stock prices have risen. Household loans have continued to grow, mainly driven by housing-related loans, and the extent of the rise in housing prices has narrowed.
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 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.	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, the inflation path is expected to be higher than previously forecast. 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 make a judgement regarding the need to raise the Base Rate further, while thoroughly assessing the inflation slowdown, financial stability risks, economic downside risks, household debt growth, monetary policy operations in major countries, and developments in geopolitical risks.

Source: Bank of Korea, BofA Global Research

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