Korea Watch

BoK preview: Domestic and external pressure eased ahead of the Jan meeting

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GEM Economics
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BoK likely to hold rates in 1st meeting in 2024

The BoK will hold its first MPC meeting of this year on Jan 11. Ahead of the meeting, we see a gradual disinflation, rising risks in real estate sector and subsiding external risks, pointing to a shift toward easier monetary policy. However, BoK is likely to retain its hawkish stance for a period of time, as stated in a new policy guidance. As such, we expect a hold decision (of 3.5%) in the Jan BoK meeting.

Domestic and external factors eased ahead of the meeting

Compared to what we observed before the last meeting, both domestic and external conditions support a shift towards an easier monetary policy stance. Domestically, inflation gradually came down to 3.2% in Dec after 3.3% in Nov. Core inflation also softened. We continue to expect headline inflation will return to mid-2% in early 2Q. Meanwhile, risks in real estate sector seem to have re-emerged, as a mid-sized constructor applied for debt-restructuring to tide over a liquidity shortage. This stirs worries on whether monetary policy is too tight and could trigger further defaults in the sector and vulnerability among NBFIs.

On the other hand, external conditions continued to improve. Specifically, **1) A more dovish Fed**: Fed decided to hold rates unchanged in the Dec FOMC meeting with dot plans revealing earlier call and lower terminal rates. Such policy turn also likely marks the peak of US yields; **2) Subsiding oil price:** despite the ongoing disruption in the Red Sea trade route, international oil prices continue to moderate on demand-supply concerns; **3) Improved trade balance**: it continued to improve amid semi-cycle upturn and lower commodity prices. We expect further improvement as export growth will likely accelerate on resilient chips demand.

...But BoK reinstates hawkish stance in the yearly guidance

Yet, just before the end of 2023, the central bank released a report providing guidelines on monetary policy for 2024. Most importantly, it reinstated guidance that the BoK will maintain a restrictive monetary policy stance for a sufficiently long period of time so that inflation will converge on the target level, while paying attention to financial stability. This likely indicates no immediate easing. We continue to expect the first rate cut could materialize in the May meeting as the earliest.

Keys to watch for the Jan meeting

In addition to inflation and growth, we believe the below factors could provide further information for the monetary policy direction: **1)** How the BoK will interpret the Fed's policy movement and the US economy soft-landing scenario; **2)** How the BoK views the recent credit crunch of a major domestic constructor, and whether is a start of further default in PF loans and consequences to financial stability; **3)** The number of MPC members who see rate changes going forward. Note there will be only six MPC members attending this meeting, as CS Park (the relatively dovish member) left for another senior government post in Dec 2023.

BoK: Bank of Korea

MPC: Monetary Policy Committee

Fed: Federal Reserve

C/A: Current Account

HH: Household

FOMC: Federal Open Market Committee

NBFI: Non-bank financial institutions

PF loan: project finance loan

Refer to important disclosures on page 5 to 6.
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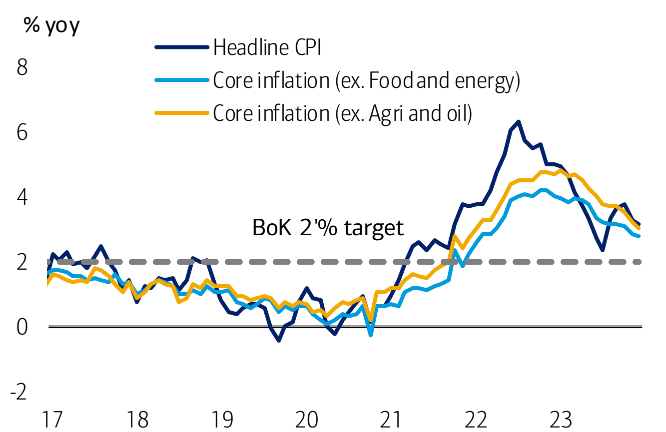
Expect more dovish tone on domestic & external factors

The BoK will hold its first MPC meeting of this year on Jan 11. Ahead of the meeting, we see a gradual disinflation, rising risks in real estate sector and subsiding external risks, pointing to a shift toward easier monetary policy.

Disinflation gradually on track while real estate sector risks re-emerge

First of all, headline CPI inflation edged lower after a brief rebound in Sep and Oct. It came down to 3.3% yoy in Nov and 3.2% in Dec, after the recent peak of 3.8% in Oct (see more in Dec CPI report). The moderation reflects lower non-core prices (including lower fresh food and retail fuel prices), as well as a moderation in core CPI inflation. We believe the disinflation trend will continue at both headline and services inflation (Exhibit 2), with headline CPI inflation to return to mid-2% in early 2Q.

Exhibit 1: CPI inflation and core trend (% yoy)
Headline CPI now on gradual disinflation trend



Source: Haver, BoK

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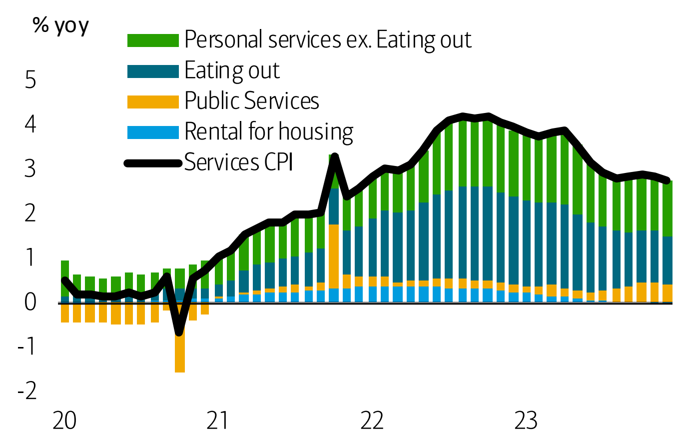
Exhibit 2: Services inflation breakdown
We expect service inflation to gradually moderate



Source: Haver, BofA Global Research

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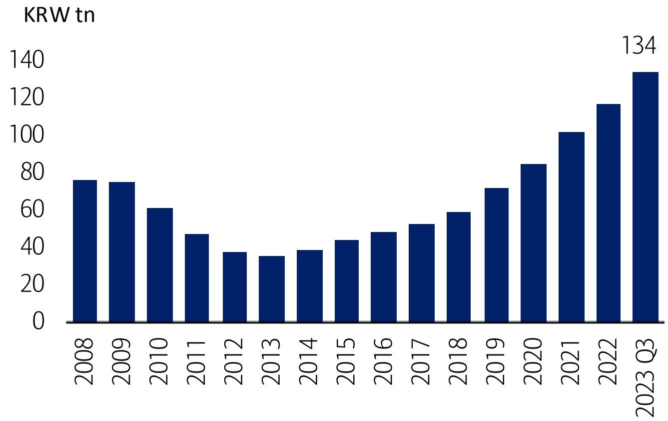
Meanwhile, cracks in real estate sector seemed to reemerge, as a mid-sized constructor applied for debt-restructuring to tide over a liquidity shortage. The builder recently announced a set of restructuring plans, including the sales of provision of equity collateral from affiliated companies and external capital injection among others. However, there are still concerns on whether they are sufficient to bring the company back on track. More importantly, this stirs worries about the risk of the elevated size of project financing (PF) loans (Exhibit 3), and its concentration among NBFIs (Exhibit 4). The government and the BoK already acted swiftly on containing the market impact.

Exhibit 3: PF loans outstanding
Despite higher rate, PF loans rose further in 2023...



Source: BoK, BofA Global Research

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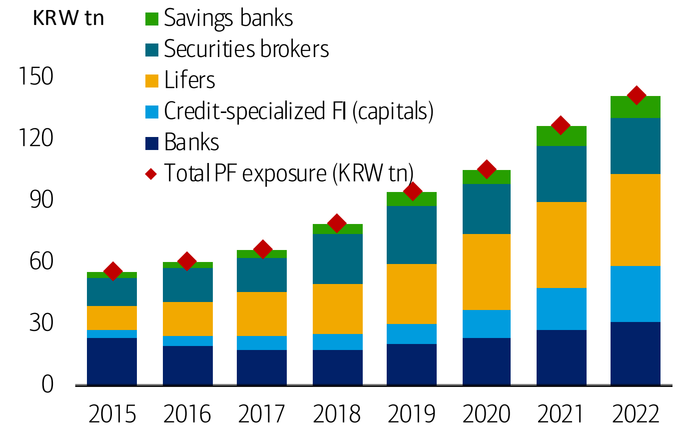
Exhibit 4: PF loans exposure by FIs
Causing worries on financial stability in NBFI sector as PF loans are largely concentrated in this sector



Source: BoK, BofA Global Research

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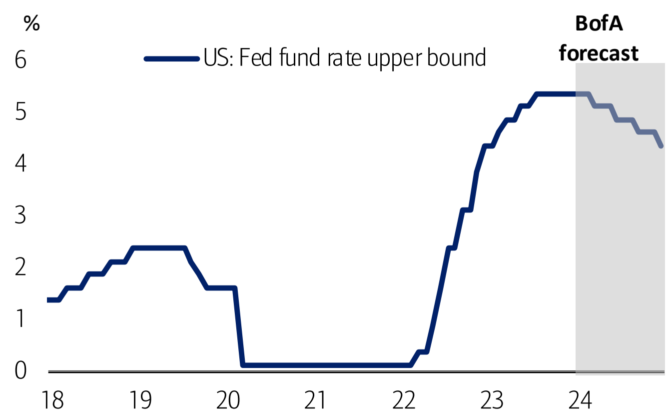
External conditions also supportive of easier monetary policy stance

External conditions have also become more favorable towards an easier policy stance. Importantly, the Fed has turned much dovish since the Dec FOMC meeting, as economic data has pointed to moderation in economic activity, disinflation, and a cooling labor market. The "dot plot" also implies further cuts compared to that in previous meeting. Our US economists now expect four-25bp cuts in Mar, Jun, Sep, and Dec, or 100bp of cuts for the year (Exhibit 5), bringing federal funds rate to 4.25-4.50% in year-end (see US Economic Viewpoint). Such policy turn also likely marks the peak of US yields (Exhibit 6).

Exhibit 5: Fed fund rates forecast
Our US economists now expect 100bp cut in 2024



Source: Haver, BofA Global Research estimates

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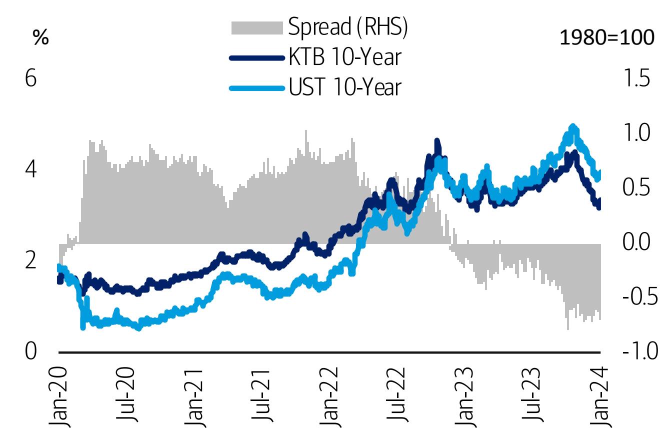
Exhibit 6: UST and KTB 10Y yields
Lower UST yields alleviate outflow pressure and bring down KTB yields



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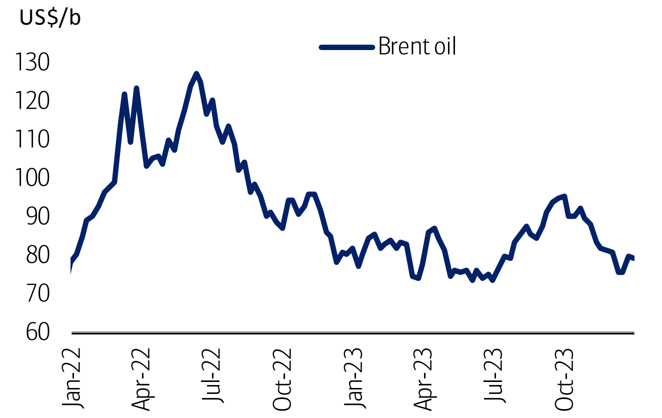
Second, falling oil prices would bring downward pressure to domestic retail fuel prices and transportation. Despite the ongoing disruption in the Red Sea trade route, international oil prices continue to moderate on demand-supply concerns. Brent once dropped below $75/b in late Dec from the peak of $95/b in October (Exhibit 7).

Third, current account continued to rise in October amid rising trade surplus, to USD6.8bn from USD5.4bn in Sep. And if looking at the trade balance in the past 3 months, we also see continued rising trade, thanks to strong auto exports to DMs and broad recovery in semi exports (Exhibit 8). We expect further improvement as export growth will likely accelerate on resilient chips demand.

Exhibit 7: Brent oil price
Brent oil price dropped further in late 4Q23



Source: Haver, BofA Global Research

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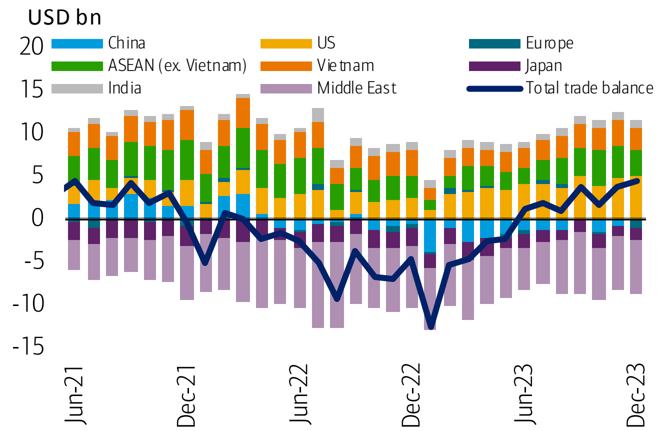
Exhibit 8: Trade surplus by economy
Trade surplus continued to rise on strong semi and auto exports



Source: Haver, BofA Global Research

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...But BoK reinstates hawkish stance in the yearly guidance

Despite domestic and external factors largely pointing to an easier policy stance, the BoK will likely remain hawkish in the near term. Just before the end of 2023, the central bank released a report providing guidelines on monetary policy for 2024. Most importantly, it reinstates guidance that the BoK will maintain a restrictive monetary policy stance for a sufficiently long period of time so that inflation will converge on the target level, while paying attention to financial stability. This likely indicates no immediate easing.

Separately, it will also provide more information on monetary policy direction in a timelier manner. Under the new arrangement, the BoK will additionally provide analyses of current financial and economic issues discussed in monetary policy meeting, 7 days post the meeting.

Keys to watch for the Jan meeting

In addition to inflation and growth, we believe the below factors could provide further information for the monetary policy direction: **1)** How the BoK will interpret the Fed's policy movement and the US economy soft-landing scenario; **2)** How the BoK views the recent credit crunch of a major domestic constructor, and whether is a start of further defaults in PF loans and consequences to financial stability; **3)** The number of MPC members who see rate changes going forward. Note there will be only six MPC members attend this meeting (Exhibit 9), as CS Park (the relatively dovish member) left for another senior government post in Dec 2023.

Exhibit 9: BoK MPC dove-hawk spectrum (left as red)
CS Park has left the Committee for senior Presidential Secretary for Economic Affairs in early December 2023

Ultra dovish	Dovish	Neutral	Mildly hawkish	Hawkish	Ultra hawkish
	SH Shin **(CS Park)**	Deputy Gov Ryoo		Governor Rhee YS Chang	YJ Cho YK Suh

Source: BofA Global Research, Bank of Korea, Media sources

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