

## Korea Watch

## Call takeaways: Discussion on monetary policy with Senior Research Fellow at KIF

## Discussion on factors that drive BoK policy in 2024

We hosted a conference call with Dr. Min Chang, Senior Research Fellow at Korea Institute of Finance (KIF) and former Director General of Research at Bank of Korea. In the call, we discussed the latest macro trends, monetary policy outlook, as well as the growth risks and opportunities in Korea in 2024.

On **inflation**, Dr. Chang expects the gradual disinflation trend in headline CPI to continue. Headline CPI is likely to reach mid-2% level in 2024, from 2.8% in 1H24 to 2.4% in 2H24. Core inflation is also moderating. Despite the disinflation trend, Dr. Chang still sees big uncertainties in the future trajectory due to geopolitical risks & other factors. Notably, supply side pressure has been building up again since 2H23, mainly driven by higher oil prices. Oil price is likely to stay as key swing factor of headline inflation this year.

On **real economy**, Dr. Chang expects a rocky recovery of 2.1% in 2024 from 1.3% in 2023, driven by better export performance but offset by weak domestic demand. Downside risks remain, including sluggish domestic demand, and geopolitical issues, and weak impulse from Chinese economy.

On **financial stability**, rising risks in project financing (PF) & commercial real estate loans and elevated household debt remain a concern. For the former, delinquency rate of PF loans has risen, and specifically non-bank exposure to PF loans is much greater than that of bank. For the latter, despite the stable structure of household debt (70% of the debt are held by the high 40% income group), it is very challenging to deal with the high household leverage with monetary policy.

On **Fed's monetary policy**, The expert believed it is still possible for BoK to cut rates before the Fed does, but subject to high uncertainty. He does not expect Fed to start easing cycle shortly, and the interest rate differential between US and Korea could be an issue to BoK if it is to ease ahead of Fed.

Taken together, Dr. Chang expects the BoK likely to start cutting rates in 2H24, specifically 25bp cut each in 3Q and 4Q (a total of 50bp cut). The chance of an early cut in 1H24 is limited if the Fed is not cutting in the 1H, and it could give a wrong signal to housing market & household debt.

*(please refer to second page for more details in Q&A session)*

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## Highlights from Q&A session

In the Q&A session, when asked about the relative importance of the four factors that influence monetary policy outlook, Dr. Chang expects inflation trajectory to be most important, followed by financial stability, then either growth or Fed's monetary policy. Given the dual mandates, he thinks that the BoK needs to first see inflation is clearly moving to the 2% target before considering rate cut. Among the inflation components, he expects oil price to stay as the most important input for inflation forecast. Domestic pressure is likely limited, given the passthrough from a strong labor market to wage growth is somewhat moderate.

When asked about the neutral rate ( $R^*$ ), Dr. Chang believes there is no structural change since the pandemic in a long-term view. Estimation suggests that it could have gone up from 0-0.5% pre-pandemic to 0.5-1.0% post-pandemic, but the time period is too short for any concrete estimation.

When asked about the potential impact of the change in MPC members in April, Dr. Chang expects it to be a key to look for and could shift the monetary policy stance in 2H24. Given that the 2 members that are leaving in April are relatively hawkish, it is likely that the incoming members are less hawkish. In that case, there is still a chance of a total of three to four cuts in 2024.

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