

## MNI BoK Preview - January 2022

**Meeting Date:** Friday 14 January 2022

**Link To Statement:** <https://www.bok.or.kr/eng/bbs/E0000634/list.do?menuNo=400069&pageIndex=1>

### Contents

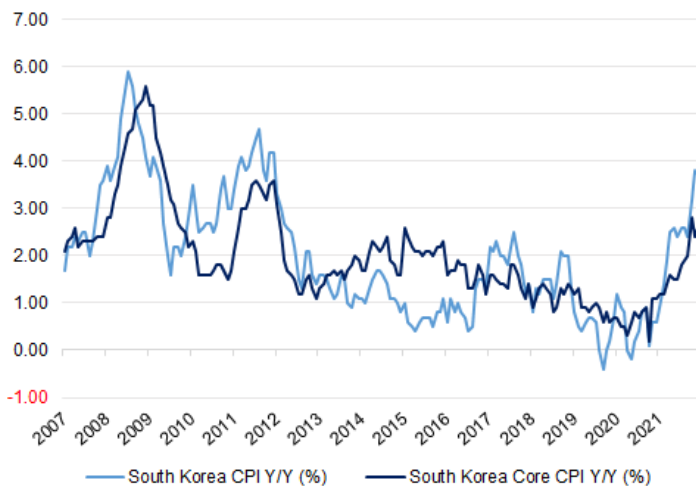
- **Page 2:** BoK 25 November 2021 Meeting Statement
- **Page 3:** MNI STATE OF PLAY: Korea CB Eyes Won, Prices On Rates
- **Page 4-5:** Sell-Side Analyst Views

### MNI POV (Point Of View): Hikes Coming, When, Not If

The Bank of Korea (BoK) will likely lift its policy rate by 25bp at its upcoming meeting, although the view among sell-side economists is not unanimous, with 13 of the 18 surveyed by Bloomberg looking for a hike this time around. The case for the continued adjustment of the degree of monetary accommodation remains clear, it is more a question of timing and how much tightening is required. A reminder that the BoK hiked rates by 25bp in November, while the next 25bp hike will take the Bank’s policy rate back to pre-COVID levels.

The Bank has conceded that inflation may run above target for longer than it has projected (remember that the BoK marked its inflation forecasts higher at its November meeting). A weaker KRW poses another source of upside risk for inflation, with USD/KRW testing KRW1,200 in recent weeks. The Ministry of Finance has noted that it is watching FX movements “closely,” with some market participants speculating that a clean break above the psychological level may result in firmer intervention from the authorities. Still, some argue that the recent run of KRW weakness will only have a marginal impact on inflation, with the impact on price pressures more than offset by the fact that such a dynamic makes Korean exports more attractive.

**Fig. 1: South Korea CPI & Core CPI (Y/Y)**



Financial stability issues are key for both the government and the BoK. The recent round of realised monetary tightening, the macroprudential spectre and expectations for further tightening have resulted in a moderation in house price growth, although that particular metric continues to operate in double digit territory in Y/Y terms.

Furthermore, the Bank will not want to face accusations of falling behind the curve when it comes to rate hikes, especially with expectations building re: a more aggressive round of tightening from the U.S. Federal Reserve.

The need for tightening is more pressing than the economic threat presented by the Omicron COVID strain, which seems to pose much less of a threat to life when compared to previous strains. We note that the recent uptick in COVID-related restrictions has had dampened domestic economic activity, although the labour market has continued to tighten.

The Bank’s guidance will be scrutinised. Hiking at this meeting would allow the BoK to point to a gradual pace of further hikes, with the upcoming general election and change at the top of the BoK (Governor Lee’s term expires in March) presenting the key short-term domestic risk events. The vote split could provide some insight here. Joo Sangyong is a well-known dove and provides the most obvious source of potential dissent in the case of a hike.

## BoK 15 November 2021 Meeting Statement

The Monetary Policy Board of the Bank of Korea decided today to raise the Base Rate by 25 basis points, from 0.75% to 1.00%.

Currently available information suggests that the global economy has continued to recover despite the spread of COVID-19 variants, supported by accelerated vaccinations and the relaxation of restrictions on economic activity in major countries. In global financial markets, the volatility of government bond yields has increased and the US dollar has strengthened, affected by concerns over the prospect of prolonged global inflation and changes in expectations about monetary policy in major countries. Stock prices, especially in advanced economies, have risen, mainly driven by favorable corporate performances. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the severity of the resurgence of COVID-19 and the status of vaccine distribution, as well as by global inflation movements and monetary policy changes in major countries.

The Korean economy has continued its sound recovery. Although facilities investment has somewhat slowed due to global supply constraints, exports have sustained their buoyancy and private consumption has shown rapid improvement supported by accelerated vaccinations and the easing of domestic COVID-19 restrictions. Labor market conditions have continued to improve, with a sustained year-on-year increase in the number of persons employed. 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.

Consumer price inflation has risen to the lower-3% level due to the accelerating increase in the prices of petroleum products and the base effect from the decline in the prices of public services last year. Core inflation (excluding changes in food and energy prices from the CPI) has risen to the mid-2% level. 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.

In domestic financial markets, the Korean Treasury bond yield has increased, especially the 3-year yield, due to heightened expectations for monetary policy normalization at home and abroad. Stock prices have risen slightly, affected by stock price movements in major countries, and the Korean won to US dollar exchange rate has fallen. The amount of increase in household loans has lessened somewhat, and housing prices have continued to increase rapidly in all parts of the country.

The Board will continue to conduct monetary policy in order to sustain the recovery of economic growth and stabilize consumer price inflation at the target level over a medium-term horizon, while paying attention to financial stability. The Board will appropriately adjust the degree of monetary policy accommodation as the Korean economy is expected to continue its sound growth and inflation to run above the target level for a considerable time, despite underlying uncertainties over the virus. In this process the Board will judge when to further adjust the degree of accommodation while thoroughly assessing developments related to COVID-19, changes in the pace of growth and inflation, the risk of a buildup of financial imbalances, and monetary policy changes in major countries.

## MNI STATE OF PLAY: Korea CB Eyes Won, Prices On Rates

By Hiroshi Inoue

TOKYO (MNI) - Increasing economic uncertainty amid high coronavirus case numbers will see the Bank of Korea tread cautiously even as it has signalled more hikes for early 2022 to cool the economy with currency and inflation levels the keys for policy decisions.

The BOK is mostly expected to keep its benchmark rate at 1.00% at Thursday's policy-decision meeting and wait until February as it further assesses monetary and financial conditions, according to sources who spoke to MNI, see: [MNI STATE OF PLAY: Bank Of Korea Governor Flags Rate Hike In Q1](#).

"My baseline scenario is that the BOK may not need to rush to raise the rate in the wake of high uncertainties over the economy amid increasing infections," Kota Hirayama, senior economist in charge of emerging economies at SMBC Nikko Securities, said.

"The inflation rate rose 3.7% in December, but it is still at a 3% level. The central bank cannot control a high inflation rate caused by the rise in raw material prices," and the now isn't good timing to raise rates, Hirayama said.

### **SLOWER HOUSE PRICE GAINS, WON IN FOCUS**

The BOK will not raise rates this week as house price gains have slowed, a person who is familiar with the South Korea economy said.

However, the source said that if the bank is seriously worried about a weaker currency the chance of a rate increase grows. The dollar rose to a KRW1200 level in early January for the highest level since July 2020 and the BOK wants to prevent the currency from further weakening, which will increase inflationary pressure. The dollar traded around KRW1189.

"Looking ahead, the risk of a weaker currency will remain high for the time being as the U.S. Federal Reserve is set to accelerate its tapering and rate hikes," the person said, adding that the number of rate hikes by the BOK this year depend on the currency moves.

Hirayama on the other hand said that a weak currency does not have serious impact on inflation rate, rather, it contributes to boosting exports.

But Kim Myoungjung, a Social Improvement and Life Design Research Department Research fellow at NLI Research Institute, said that the BOK will raise the policy rate to 1.25% this week amid persistently high inflation. Kim added that more two rate hikes are expected this year as the Fed is set to raise the policy rate, which will widen an interest rate gap between U.S. and South Korea.

BOK Chairman Lee Juyeol said on Dec. 31 that the bank must carefully examine the possibility that inflationary pressure continues for longer than expected. He also said the degree of monetary policy should be adjusted based on economic conditions in an appropriate manner.

## Sell-Side Analyst Views

**Barclays:** We expect the BoK to again raise its policy rate by 25bp, to 1.25%. The decision is likely to be non-unanimous: we expect 1-2 members to vote for no change. We still view the timing as a close call between the January and February meetings. However, the sustained period of elevated inflation has increased upside risks to the BoK's 2% inflation forecast in 2022. Hard data also held up in Q4, implying 4% growth in 2021 should be met. Korea's COVID situation also seems to be improving, with critically ill cases and deaths falling from December peaks. This may provide a window for the BoK to tighten sooner rather than later. If the policy rate is raised to 1.25%, we think the tone of the Governor's comments will be cautious, citing still heightened external uncertainties around the spread of the Omicron variant. He will likely reiterate that inflation pressures seem to be persistent, but also that earlier rate hikes have started to rein in household leverage and property-market price increases. We also think the number of dissenters will be of particular interest. If there is more than one dissenter (besides the known dove Dr. Joo Sangyong), we think the market may view this as a 'weak' hike, as it would reduce the likelihood of a follow-up hike in Q222.

**DBS:** The BoK is expected to keep the policy rate unchanged this week before raising it again to 1.25% in February. Current economic conditions still justify the need for further monetary policy normalisation. Although consumption growth has slowed due to the rebound in domestic COVID cases and the retightening of restriction measures, exports continued to expand strongly to offset. Meanwhile, CPI inflation stayed well above the BoK's 2% target, surging by 3.7% YoY in December after the 3.8% rise in November. Nonetheless, considering that the BoK just delivered a 25bps hike at the previous meeting and the Governor highlighted the Omicron risks recently, we think it will wait till the February meeting to further raise interest rates.

**Goldman Sachs:** We expect the Bank of Korea to raise its policy rate by 25bp to 1.25%, marking the third hike since the August liftoff last year and a back-to-back hike following the 25bp increase in the previous meeting in November. We think a January hike, while a close call, is more likely than February, given market pricing and the political calendar. That said, the Governor's press conference will unlikely signal the continuation of policy rate normalization as rapid as recent hikes, highlighting both upside risks to inflation and near-term downside risks pertaining to the pandemic situation. In our view, monetary policy normalization after a January hike will likely proceed more gradually given elevated macro uncertainties, substantial slack in labor markets, and vulnerability of highly indebted households to rapid rate rises. We continue to forecast a total 50bp policy rate hike for 2022, with the second hike for the year likely taking place in August, albeit with high uncertainties stemming from the upcoming presidential election.

**ING:** Although Governor Lee Ju-yeol has indicated that rates have not yet peaked and would probably rise again in Q122, the last meeting didn't provide any indication that there would be a further imminent cut, so we think if we get one more in the first quarter, it will probably be at the end of the quarter, which will also coincide with Governor Lee's last meeting before he steps down. He may of course opt to leave it up to his successor.

**J.P.Morgan:** The BoK's recent communications highlighted real GDP growth, inflation, financial imbalances, and major foreign central banks' policy changes as factors guiding policy rate adjustments. Since the hike last November, while the real GDP growth outlook and financial imbalances likely have changed only marginally in the BoK's assessment, we see notable upside risk to the BoK's inflation outlook while the U.S. Fed's policy normalisation may be more aggressive than the BoK's previous expectation. Against this backdrop, we continue to expect that the BoK would hike 25bp this week to return to the 1.25% pre-COVID policy rate level. In terms of forward guidance after the meeting, the BoK may stress a gradual pace of policy normalization, which in turn may imply decisions to stand pat at coming meetings in H122.

**Morgan Stanley:** The BoK is likely to raise policy rate from 1.00% to 1.25% at this meeting. The BoK's hawkish stance has been confirmed during various occasions in the past such as the monetary policy meeting, the briefing on its inflation target and the announcement of the 2022 monetary policy direction. The next rate hike is more likely to take place in January than in February. Macro data supports imminent action and the COVID-19 situation is stabilising at the moment, whereas political uncertainty is likely to see a big increase in February. The hike decision

will be a unanimous one; we expect the next hike in Q2. Sangyong Joo, a well-known dovish member, is no longer likely to cast a dissenting vote. We believe the policy statement will continue to emphasise the need to adjust the degree of monetary policy accommodation, citing upside risks to inflation. We also still expect one 25bp rate hike every quarter this year. There will be a rate hike in Q2 despite the uncertainty regarding the appointment of a new BoK Governor.

**Societe Generale:** The BoK is likely to raise its policy rate from 1.00% to 1.25% at 14 January meeting. The BoK's hawkish stance has been confirmed during various occasions in the past such as the monetary policy meeting, the briefing on its inflation target and the announcement of the 2022 monetary policy direction. The next rate hike is more likely to take place in January than in February. Macro data supports imminent action and the COVID-19 situation is stabilising at the moment, whereas political uncertainty is likely to see a big increase in February. Rate hike decision in January will be a unanimous one; we expect the next hike in Q2. Sangyong Joo, a well-known dovish member, is no longer likely to cast a dissenting vote. We believe the policy statement will continue to emphasise the need to adjust the degree of monetary policy accommodation, citing upside risks to inflation. We also still expect one 25bp rate hike every quarter this year. There will be a rate hike in Q2 despite the uncertainty regarding the appointment of a new BoK Governor, economic recovery and given that the BoK has been amongst the earliest central banks to normalize rates in Asia, there's probably flexibility for the BoK to pace the timing of further rate normalisation. In this context, we see the next move at the Feb meeting. We think macro developments, rather than the timing of elections are the more important determining factor with regard to the BoK's next move.

**UOB:** Inflation is expected to remain elevated this year due to sustained high oil prices and the economic recovery coupled with supply disruption. After rising to a decade-high of 2.5% in 2021 (2020: 0.5%), we expect headline inflation to average 2.0% this year while core inflation could edge slightly higher from 1.8% in 2021. The monthly headline inflation is likely to stay above the BOK's target through H122. South Korea's economic fundamentals have stayed strong but export growth is expected to cool due to the moderation of growth in the major economies and a high comparison base while a slowdown in China poses further downside risk. Overall, export growth had rebounded 25.8% in 2021 from - 5.5% in 2020. The government forecasts exports to post a small gain of 2% this year. We continue to project the next BOK rate hike in Q122, likely at the 24th Feb meeting instead of the upcoming meeting on 14th Jan in line with its gradual normalisation approach. The BOK remains wary of the coronavirus spread that would threaten the global recovery as well as an increase in credit risk among households and small businesses as the central bank raises interest rates.