

## MNI BoK Preview - May 2022

**Meeting Date:** Thursday 26 May 2022

**Link To Statement:** <https://www.bok.or.kr/eng/bbs/E0000627/list.do?menuNo=400022>

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### MNI POV (Point Of View): 25bp Hike Seemingly Done Deal

A 25bp hike come the end of the BoK's May meeting is seemingly a done deal. Such a move would take the policy rate to 1.75%, the highest level observed since H119. All 18 economists surveyed by Bloomberg look for a 25bp hike.

Inflation remains the biggest concern within the Korean policymaking sphere. The MoF recently described the domestic inflation situation as grave, with a meaningful slowing of upward price pressure unlikely to materialize in the near term. The main inflation readings continue to surprise to the upside. Headline CPI is running at +4.8% YoY, the highest level observed since 2008. Core inflation also continues to trend higher, last at +3.6% YoY. Both metrics are well above BoK's 2% target. Commodity prices remain elevated, while supply chain pressures have worsened since the start of the year due to the Russia-Ukraine conflict and China's recent COVID-related lockdowns. Korean import price pressures remain elevated, sitting at 35% YoY in most recent print. Korean won weakness, with the currency down nearly 14% vs. the USD in YoY terms, is exacerbating import price pressures. The consumer confidence survey for May also showed an uptick in both inflation perceptions (to 3.4% from 3.2%) and inflation expectations (to 3.3% from 3.1%). Elsewhere, unemployment remains at multi decade lows, with tight labor market conditions expected to keep wage pressures elevated. We should expect a mark-to-market exercise when it comes to the Bank's updated inflation forecasts.

Since the April meeting, the external growth backdrop has become less favorable. We have seen sharp downgrades to sell-side projections for Chinese economic growth during 2022, while US growth expectations are also being marked lower. Accordingly, Korean export growth has continued to lose momentum through the first half of May. Domestic indicators are holding up, but given Korea's leverage to the global business cycle, heightened uncertainty surrounding external demand warrants a more cautious approach to monetary tightening i.e a 25bp hike, rather than 50bp.

Indeed, New BoK Governor Rhee Chang-yong stated that a bigger step up in the pace of tightening could be warranted, although he noted that any such move would be made after reviewing further data, with the potential for such move at the Bank's July or August decision. A senior Bank official subsequently played down Rhee's remarks, pointing to the Governor merely emphasising the principles deployed when making policy decisions. Market pricing looks for an additional 60bp of tightening over the next 6 months (assuming a 25bp hike is deployed in May). Further out, the policy rate is expected to hit 3.00% in 12 months' time. Beyond that point expectations start to flatten out, with very modest cuts priced in over a 2- to 3-year horizon (a ~2.90% policy rate is priced over a 3-year window). Such a hiking cycle would take the policy rate back to levels last seen in 2012, moving it into contractionary territory given the long-term decline in the neutral rate setting.

Comments surrounding the KRW will also garner attention. FX stability made it into the joint leader's statement released after the Biden-Yoon weekend summit. The BoK has already noted that it will work more closely with the Finance Ministry on this issue.

## BoK 14 April 2022 Meeting Statement

The Monetary Policy Board of the Bank of Korea decided today to raise the Base Rate by 25 basis points, from 1.25% to 1.50%.

Currently available information suggests that inflation has accelerated while the recovery of the global economy has somewhat moderated, affected by the Ukraine crisis. In global financial markets, government bond yields in major countries have risen sharply and the US dollar has strengthened, mainly due to changes in expectations about the pace of the US Federal Reserve's policy normalization. Stock prices have rebounded after a considerable decline. Looking ahead, the Board expects that the global economy will resume its trend of recovery, supported by the easing of COVID-19 restrictions in major countries, but sees it as likely to be affected largely by COVID-19 developments, global inflation movements, monetary policy changes in major countries and geopolitical risks.

The Korean economy has continued to recover. Exports have sustained their buoyancy while facilities investment has slowed due to global supply constraints. Private consumption has recently shown modest improvement thanks to the easing of domestic COVID-19 restrictions, after having moderated. Labor market conditions have continued to improve, with the year-on-year increase in the number of persons employed remaining high. Going forward, the economy is likely to sustain its recovery albeit partly affected by the Ukraine crisis, as exports are expected to continue their solid trend of growth while private consumption is likely to improve. GDP growth this year is projected to be somewhat below the February forecast of 3%.

Consumer price inflation has risen significantly to the lower-4% level due to soaring prices of petroleum products as well as the accelerating increase in the prices of industrial products and personal services. Core inflation (excluding changes in food and energy prices from the CPI) and the inflation expectations of the general public have increased to the upper-2% level. Looking ahead, it is forecast that consumer price inflation will remain high in the 4% range for some time, and run substantially above the February forecast of 3.1% for the year overall. Core inflation is forecast to remain around 3% for a considerable time.

In domestic financial markets, long-term market interest rates and the Korean won to US dollar exchange rate have risen significantly while stock prices have fluctuated considerably, mainly driven by global financial market movements. Household loans have decreased slightly and housing prices have fallen slightly, especially in the Seoul metropolitan area.

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 recovery and inflation to run above the target level for a considerable time, despite underlying uncertainties in domestic and external conditions. In this process the Board will judge when to further adjust the degree of accommodation while thoroughly assessing developments related to COVID-19, the risk of a buildup of financial imbalances, monetary policy changes in major countries, geopolitical risks, and the trends of growth and inflation.

## Key BoK Economic Outlook Forecasts (February 2022)

Table 2. Economic growth forecasts

	(year-on-year, %)						
	2021			2022 <sup>e</sup>			2023 <sup>e</sup>
	H1	H2	year	H1	H2	year	year
<b>GDP</b>	4.0	4.0	4.0	2.8	3.1	3.0	2.5
Private consumption	2.4	4.8	3.6	3.9	3.2	3.5	2.6
Facilities investment	12.6	4.1	8.3	-1.3	5.8	2.2	1.7
Intellectual property products investment	4.0	3.7	3.9	4.2	3.7	3.9	3.8
Construction investment	-1.5	-1.5	-1.5	0.6	4.0	2.4	2.3
Goods exports	14.4	6.0	9.8	4.5	2.5	3.4	2.2
Goods imports	12.5	11.2	11.8	5.6	2.1	3.8	2.3

Table 3. Employment forecasts

	(ten thousand persons, percent)						
	2021			2022 <sup>e</sup>			2023 <sup>e</sup>
	H1	H2	Year	H1	H2	Year	Year
<b>Changes in number of persons employed<sup>1</sup></b>	12	62	37	36	20	28	20
Unemployment rate	4.5	2.9	3.7	3.8	3.3	3.6	3.7
(S.A.)	4.0	3.3	-	3.5	3.6	-	-
<b>Employment-to-population ratio<sup>2</sup></b>	59.8	61.2	60.5	60.1	61.1	60.6	60.7
(aged 15 to 64, OECD basis)	[65.8]	[67.2]	[66.5]	[66.4]	[67.3]	[66.8]	[67.2]

Notes: 1. Year-on-year changes.

2. 15 years of age &amp; above.

Table 4. Inflation forecasts

	(year-on-year, percent)						
	2021			2022 <sup>e</sup>			2023 <sup>e</sup>
	H1	H2	Year	H1	H2	Year	Year
<b>Headline consumer price inflation</b>	2.0	3.0	2.5	3.5	2.7	3.1	2.0
<b>CPI excluding food and energy (OECD core CPI)</b>	1.0	1.8	1.4	2.7	2.5	2.6	2.0
<b>CPI excluding agricultural products and oil</b>	1.4	2.3	1.8	3.0	2.7	2.8	2.2

## MNI STATE OF PLAY: S. Korea Cenbank To Hike To 1.75% On Prices

By Hiroshi Inoue

TOKYO (MNI) - The Bank of Korea is expected to raise its policy interest rate to 1.75% from 1.50% on Thursday, putting its top priority on curbing inflation over concerns of a slower economy, observers said.

"A 25 basis point rate hike is expected this week, although the new governor indicated a 50 basis point rate hike," Kota Hirayama, senior economist in charge of emerging economies at SMBC Nikko Securities, said. In his first policy review as governor, Rhee Chang-yong had made it clear in his confirmation that he is focused on inflation, but he has said he is flexible on monetary policy direction.

Hirayama also said the focus on prices comes against concerns on slow growth in China, a key trading partner. "Unless the economy contracts and the labor market situation worsens sharply, the bank's stance of curbing inflation rate will not change," he added.

### INFLATION

South Korea's consumer prices jumped 4.8% y/y in April to the highest since October 2008, with May inflation data, due on June 3, a wildcard for the pace of a second straight hike, See: [MNI STATE OF PLAY: South Korea's Cenbank Focused On Inflation](#).

Hirayama said that the BOK may consider a 50 basis point rate hike if it estimates inflation will surge further in the May data.

As well, the Korea Development, a Korean government agency, on May 18 recommended the BOK raise the policy interest rate as consumer price index this year is expected to rise above 4%.

"Macroeconomic policy needs to gradually normalize monetary accommodation in light of the pace of recovery and simultaneously, tame high inflation and ballooning sovereign debt," the KDI said. "Monetary policy should slowly raise the base rate to keep the expected inflation within the target range." The BOK targets inflation around 2.0% over the medium term.

The KDI raised its inflation forecast this year to 4.2% from 1.7% in November 2021 and lowered its GDP forecast to 2.8% from 3.0%.

### CURRENCY TOO

"The BOK will likely raise the policy rate on the back of the high inflation rate and amid concern over a weaker currency," according to a person familiar with the BOK's policy views. The Korean won weakened to 1,288.50 against the USD on May 12, but has since recovered slightly to around KRW1,270.70 on Monday.

Another factor for the currency is the expected pace of hikes by the U.S Federal Reserve this year, particularly if it accelerates tightening. Rhee has said that he is paying attention to the Fed as an at least 50 basis point hike is expected at the next meeting, raising concerns over capital outflow from the financial markets and the Korean won's further depreciation against the USD.



## Sell-Side Analyst Views

**ANZ:** We expect the BoK will raise its policy rate. The April meeting minutes were hawkish, and more recent economic data will only add to existing inflation concerns. For instance, April's inflation surprised to the upside, and with utility bills rising, economic reopening adding to demand-side price pressures and the gap between PPI and CPI still quite sizeable, inflation is likely to remain elevated. A deteriorating balance of payments position at a time when the US Fed is normalising monetary policy will also add impetus for the BoK to act sooner rather than later. It's worth noting that the new BoK governor recently commented that the possibility of raising the base rate in steps of 50bp or more cannot be ruled out. We suspect this won't materialise in May, but it's difficult to rule out a larger-than-usual hike in Q3, when there will be more clarity on the extent of the pace of US policy normalisation and the persistence of inflation (while base effects turn more favourable in H2 2022, global commodity prices remain elevated and the government's latest supplementary budget adds upside risk).

**Barclays:** Following recent CPI strength and hawkish statements from the central bank, we expect the Bank of Korea to hike its policy rate by another 25bp.

**DBS:** The BoK is expected to raise the benchmark repo rate by another 25bp to 1.75%. Judging from the recent comments from the new BoK governor Rhee Chang-yong and the new president Yoon Suk-yeol, stabilising prices remains the top policy priority in the near term. The latest CPI numbers surprised on the upside again - 4.8% YoY in April. Trade data have started to soften, reflecting the impact of Shanghai lockdown. But consumption has begun to regain steam, as the Omicron wave subsides and the pandemic-related restriction measures have been largely scrapped. The current macroeconomic conditions still justify a further rise in policy rate towards the 2% level.

**Goldman Sachs:** We expect the BoK to raise its policy rate by 25bp to 1.75%. We expect Korea's central bank to avoid raising its policy rate in a big step (50bp), given predominantly external inflation pressures (which are decelerating recently), strong headwinds to growth, and vulnerability of the economy to sudden rises in borrowing costs. For the central bank's macro forecast revisions, we expect a large upward revision to the BoK's 2022 inflation forecast from 3.1% in February (vs. GS forecast of 4.5% and consensus of 4.0%) and a modest downward revision to the 2022 growth forecast from 3.0% (vs. GS forecast of 2.3% and consensus of 2.7%). Markets will be watching for the new governor's comments on risks surrounding the growth and inflation outlook and updated assessments of financial stability risks, including impact from rapid Fed rate hikes and housing markets in Korea.

**ING:** We expect a 25bp rate hike. Price pressures remain high while fiscal conditions will support growth. This will justify frontloading a rate hike. However, some markets are speculating a possible 50bp hike in May, but we think that the BoK won't rush and will keep the powder dry for potential future hikes.

**J.P.Morgan:** We look for a 25bp hike of the policy rate and a significant upward adjustment to the annual inflation forecast (mark to market). The forward guidance and press conference should maintain the hawkish bias to tame inflation expectations, while acknowledging modest downside pressure on growth outlooks from the external demand environment. As a hawkish risk case to our policy and inflation outlooks, we are mindful of sustained upward pressure in core prices from processed food prices (with spillover from imported raw materials) and wage inflation. A notable upside surprise in core inflation may lead to even more preemptive policy rate normalization by 50bp at one of the coming meetings (most likely in 3Q), yet we still view 25bp steps toward neutral as more likely.

**Morgan Stanley:** We expect BoK to hike another 25bp. Apart from April's 4.8%Y inflation print and continued rise in public inflation expectations, the minutes from the April meeting also showed that a number of MPB members are concerned over potential wage-price spiral. We think concern over rising inflation is likely shared among the members, and hence do not think the retirement of Ms. Lim (a board member perceived to be more hawkish) as a meaningful factor that could lead to a pause in the policy rate normalisation path. Looking ahead, we expect BoK to take the policy rate up to 2.5% by 4Q22 as inflation is likely to average 4.1% in 2022 and 2.6% in 2023, outside of BoK's inflation target point of 2%. However, we would still characterize these hikes as policy rate normalization rather than tightening. This is because we expect the real policy rate to average near the 0% in 2023. Previously,

the BoK had commented that unlike the Fed which needs to move into restrictive territory, Korea's macroeconomic conditions do not require policymakers to take the real policy rate beyond neutral

**NatWest:** We expect the BoK to hike by 25bp to 1.75%, continuing its policy tightening cycle and moving at a faster pace. Headline and core inflation are both well above the 2% target, with expectations that they will remain there for some time yet. Broad-based inflationary pressures and a still-weak KRW suggest that the need for higher policy rates remains, and the end of the cycle is not in sight yet.

**Scotiabank:** They hiked with no boss at the April 13th meeting. Now with a boss having been appointed - Governor Rhee Chang-yong - the Bank of Korea is expected to hike again and raise its bank rate by 25bp to 1.75%. That would make this the fifth quarter-point hike of the cycle that began last August and therefore gives the RBNZ a bit of a run for the money. Inflation is running at 4.8% y/y with core at 3.6% compared to the 2% inflation target.

**Societe Generale:** The BoK will raise its policy rate by 25bp to 1.75% at the policy meeting on 26 May. Inflation concerns have become more pronounced, with headline CPI hitting another record high and unemployment still at a record-low level. We don't see a "big step" 50bp hike as very likely in May given the ever-present concerns on growth, especially from lockdowns in China. We now expect the BoK policy rate to hit a terminal level of 2.50% near the end of 2022. It would be difficult for policymakers to extend the rate-hike cycle into 2023, as we expect the peak-out of inflation in 2H22. We don't expect the BoK to strictly abide by the inflation target of 2%, given their worries about "secular stagnation" as per Governor Rhee's inauguration speech.

**TD Securities:** We look for a 25bp hike. BoK Governor Chang-yong recently stated that a 50bp hike cannot be ruled out. Risks of 50bp come from record low real rates, elevated CPI at 4.8% y/y, its highest since 2008, weaker KRW exacerbating already high imported price pressures caused by firmer commodity prices. However, economic momentum is likely to weaken, suggesting more limited impetus for aggressive tightening.

**UOB:** South Korea's inflation continued to climb in Apr with the headline CPI above 4% for the second straight month at 4.8% y/y, the highest since Oct 2008. We now think a back-to-back 25bp interest rate hike to 1.75% on 26 May is fairly likely given the near-term inflationary pressures since there will not be an MPC meeting in June and the next meeting will only be in July.