# MNI BoK Preview - January 2023

**Meeting Date:** Friday 13 January 2023

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

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## MNI POV (Point Of View): 25bps Hike, Then Pause

Tomorrow the BoK is expected to deliver a 25bps hike, which would take the policy rate to 3.50%. This isn't a uniform expectation with 5 out of 16 economists surveyed by Bloomberg expecting no change, while the remainder are forecasting a 25bps hike. Our base case is for a 25bps hike and then a pause by the BoK.

A pause at the January meeting can't be ruled out. There has been a cumulative 275bps in tightening since late 2021. A policy rate at 3.25% should also be viewed as comfortably in the neutral zone, if not tighter, from a long-term standpoint.

There is also evidence tighter financial conditions is hurting domestic growth outcomes. Employment growth is slowing, with the unemployment rate ticking up more than expected in the most recent print (3.3%). Consumer spending has softened, with retail sales down for three straight months to November. The government also appears concerned about the property sector, with a number of measures aimed at supporting the sector. A recent survey of economists showed the consensus expected a -0.3%y/y contraction in Q4 growth (see this link for more details).

Beyond this, external headwinds remain, with export growth on a softer footing in the latter stages of 2022. Early data for 2023 doesn't suggest a strong turnaround, still falling at a double digit pace on an average daily basis for the first 10-days of January. However, the improved outlook from China should support export growth as we progress further into 2023.

Headline inflation pressures are comfortably past the 2022 peak (latest 5.0% from the 6.3% peak in July). Consumer expectations for inflation continue to come down. The last survey print from Dec last year showed expected inflation at 3.8%, down from 4.2% in Nov.

Higher electricity prices in the early part of 2023 may stabilize this downtrend in headline prices. Core inflation pressures also remain sticky. The last print held at 4.8% y/y for the third straight month. A concern for the BoK could be elevated underlying inflation pressures, particularly with the core print so far above the 2% target.

In a recent speech, BoK Governor Rhee stated that while the central bank would aim to deliver a soft landing, its primary goal is bringing inflation pressures back under control. This, coupled with still strong core inflation pressures tilts the odds towards another 25bps hike, although as the above suggests, this is a close call. We would expect the BoK Governor to signal a pause is likely post tomorrow's meeting outcome (assuming a 25bps hike is delivered). Time to assess the impact of tighter policy on the economy and inflation may be language that the Governor uses.

A much stronger won, with USD/KRW nearly 14% off its Oct 22 highs is another factor that argues for a potential BoK pause. However, we don't think this will be central to BoK thinking, with inflation and the outlook likely to dominate.


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# BoK November 24 2022 Meeting Statement

The Monetary Policy Board of the Bank of Korea decided today to raise the Base Rate by 25 basis points, from 3.00% to 3.25%. The Board judges that the policy response to ensure price stability should be continued as inflation has remained high. The size of the Base Rate hike was judged to be appropriate at 25bp, in overall consideration of the easing of risks in the foreign exchange sector and the contraction of short-term financial markets, while the economic slowdown is expected to be greater than forecast in August.

Currently available information suggests that the global economic slowdown has continued, affected by the high inflation, ongoing policy rate hikes in major countries and the prolonged Ukraine crisis. In global financial markets, the US dollar has weakened and long-term market interest rates have fallen, as risk aversion has partly subsided on the expectations of an adjustment to the pace of the US Federal Reserve's policy rate hikes. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the movements of international commodity prices and global inflation, monetary policy changes in major countries and US dollar trends, and geopolitical risks.

Domestic economic growth has continued to slow with exports shifting to a decrease, although private consumption has maintained its recovery trend. Labor market conditions have continued to be favorable with a low unemployment rate, despite a slowing increase in the number of persons employed. Going forward, domestic economic growth is expected to weaken, affected by the global economic slowdown and the increase in interest rates. GDP growth for this year will be consistent with the August forecast of 2.6%, but that for next year is projected to be 1.7%, considerably lower than the August forecast of 2.1%.

Consumer price inflation has remained high at 5.7% in October due to increases in electricity and gas fees and the accelerating price increases in processed food products, although increases in the prices of petroleum products have moderated. Core inflation (excluding changes in food and energy prices from the CPI) and the inflation expectations of the general public have stayed high at the lower-4% level. Looking ahead, it is forecast that consumer price inflation will somewhat decrease due to the base effect and the economic slowdown, but will remain high at the 5% level for some time. Consumer price inflation is projected to be 5.1% in 2022 and 3.6% in 2023, slightly below the August forecast of 5.2% in 2022 and 3.7% in 2023, but uncertainties are judged to be high related to the movements of exchange rates and global oil prices, the degree of economic slowdown at home and abroad, and the size of increases of electricity and gas fees.

In the financial and foreign exchange markets, the long-term Korean Treasury bond yield and Korean won to US dollar exchange rate have decreased and stock prices have risen due to expectations of an adjustment to the pace of monetary tightening in major countries. However, in the short-term financial markets, yields on project financing asset-backed commercial paper (PF-ABCP) have risen significantly and their transactions have shrunk. Household loans have increased only slightly and housing prices have further decreased in all parts of the country.

The Board will continue to conduct monetary policy in order to stabilize consumer price inflation at the target level over a medium-term horizon as it monitors economic growth, while paying attention to financial stability. The Board sees continued rate hikes as warranted for some time, as inflation is expected to remain high, substantially above the target level, although the domestic economic growth rate has slowed. In this process the Board will determine the size and pace of further increases of the Base Rate while thoroughly assessing the degree of persistence of high inflation, the pace of growth, monetary policy changes in major countries, financial stability conditions, and geopolitical risks.


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# MNI BOK WATCH: 25bp Hike Expected, Tightening Pause On Radar

By Hiroshi Inoue

(MNI) TOKYO - The Bank of Korea is expected to raise its Base Rate by 25bp to 3.5% at Friday's meeting, steering it to a level cited by Governor Rhee Chang-yong as a possible peak rate, as policymakers prioritise fighting inflation despite a slowing economy.

Likely taking cumulative monetary policy tightening to 300bp since August 2021, a few board members may call for a pause in the rate hiking campaign after Friday's expected hike amid growing concerns about the growth outlook as the slowing global economy weighs on exports. Some economists have argued to keep the rate steady at 3.25bp given inflation is slowing and growth is set to weaken. The BOK hiked 25bp at its last meeting in November, saying the increase was "warranted" as inflation was "substantially" above its target level. (See MNI BOK WATCH: Hikes 25bp, Flags More To Come As GDP, CPI Cut)

South Korea's consumer price index rose 5.0% y/y in December, unchanged from 5% y/y in November and down from its peak of 6.3% y/y in July.

"The BOK will likely raise the rate by 25 basis points this week as the bank has put a high priority on inflation rate. The headline CPI is expected to slow further but core CPI is accelerating, indicating the bank needs to raise the rate," Kota Hirayama, senior economist in charge of emerging economies at SMBC Nikko Securities, said. Hirayama said the focus is on whether Governor Rhee will maintain a tightening stance or signal a pause at Friday's press conference.

Governor Rhee identified 3.5% as a possible peak rate at a conference in November, but added that could change depending on economic conditions. He has voiced concerns over the pace of monetary tightening amid rising credit stress in the corporate bond market.

***WAIT AND SEE***

A person who is familiar with South Korea economy and financial conditions said the BOK is expected to take a wait-and-see attitude after raising the policy rate this week. "The currency remains solid but the implied volatility remains high, indicating concern over a weaker currency. The BOK needs to follow the rate hike by the Federal Reserve to prevent the current from falling," the person said.

A stronger won will support the BOK in fighting inflation but the bank is worried about the risk of weaker currency due to a widening interest rate gap with the U.S. The currency traded at around KRW1239.68 against the U.S. dollar on Tuesday, after falling to KRW1440 in late September to its lowest level since March 2009. (See KRW : Won Outperformance Persists On Equity Rebound/Strong Portfolio Inflows)

The weaker outlook for South Korea's exports amid slower global economy may prompt the BOK to pause the rate hike after this week meeting. South Korea's exports fell 9.5% y/y in December, the third consecutive drop, following a 14% y/y decline in November.

Hirayama said that the downside risk to the economy is strengthening but the BOK still places emphasis on fighting inflation. "The focus is how the BOK will ease its credit grip after ascertaining slowing inflation rate or the bank will be worried about weaker economy," he said.


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# Sell-Side Analyst Views

**ANZ:** We expect the Bank of Korea (BoK) to conclude its current rate hike cycle with a 25bp increase this Friday which will take the policy rate to3.50%. Nonetheless, the odds that the central bank will stand pat have also risen. Recent inflation data suggest that demand-pull price pressures have started to ease, while expectations are also moderating. Although higher electricity tariffs in January will likely push inflation to above 5% temporarily, we expect it to fall sustainably below 5% from March 2023. The growth slowdown is broadening amid weakening external demand and a faltering property market. As evident in a host of recent measures, the government has already started to focus on supporting economic activity. The improving outlook for South Korea's balance of payments should give the central bank more scope to prioritise domestic conditions and reduce the risk of a hard landing. The rising need for policy coordination calls for a monetary policy pause; the hurdle for a pivot towards an easing bias is high.

**Barclays:** We expect the BoK to deliver the final 25bp hike of the cycle next week. We believe still-high inflation in December and modest upside risks from the latest announced administered price hike plans suggest only a gradual pace of disinflation. We expect stronger signals of a pause from the BoK this time with a dissenting vote in favour of a hold. With stronger growth headwinds from the global slowdown and tight financial conditions, we expect one dissenting vote from the dovish camp in the committee, paving the way for a pause from the February meeting. While we see a high hurdle for further hikes given already high stress on the economy, we expect the BoK to deliver relatively neutral to hawkish comments during the press conference. This would leave the option for further hikes open, against higher-than-expected inflation or potential surge in FX market volatility as the Fed continues to hike. We expect the BoK to cut by 25bp in Q4 23 as growth momentum remains weak in H1 amid softer inflation prints.

**Bank Of America:** We expect the Bank of Korea to continue its rate hike cycle and raise the policy to 3.50% on 13 Jan. On the back of headline CPI inflation hovering above 5% and Gov Rhee's New Year speech emphasizing price stability as his foremost policy priority, we see the BoK looking to reach above the neutral rate range of 2.25-2.75%. However, we now see them pausing from here as dissenters likely vote against the hike in Jan. We see the rate held unchanged through 3Q23.

**Citi:** In the MPB meeting on January 13th, we expect BoK to deliver a hawkish hold at 3.25% with two minor opinions (likely Suh Young Kyung and Park Ki Young) for a +25bps rate hike. BoK is likely to keep policy rate unchanged due to the following factors: [1] rising downside risks in economic growth & housing market, [2] a peak-out of headline inflation & inflation expectations, [3] stabilizing global oil prices, [4] a sharp fall in USDKRW as well as [5] still historically wide spreads in short-term money market BoK may keep highlighting inflation stabilization while not delivering an additional hike in 1H23 and also limiting the odds for any rate cut in near term. BoK may prefer avoiding the risks of over-tightening as well as the risk of premature dovish pivot. BoK may admit substantial downside risks in its 2023E GDP (+1.7%). We keep our assigned probability for BoK's terminal policy rate to approx. 60% for 3.25% and approx. 40% for 3.50% by 1Q23.

**DBS:** The Bank of Korea is expected to raise the benchmark rate further to 3.50% from 3.25% at Friday's meeting. But Governor Rhee may hint that the current tightening cycle is close to an end. December CPI inflation remained well above the 2% target at 5.0% YoY and the underlying core inflation also remained strong at 4.8%. On the other hand, the sharp decline in Nov-Dec exports and slide in retail sales point to the chances of a QoQ GDP growth contraction in 4Q22. The recent recovery of the KRW and stabilisation of corporate bond yields also suggest the easing of capital outflow pressures and credit market stress. While containing inflation remains the BOK's policy priority for the time being, a policy pivot looks increasingly likely in the coming months as growth headwinds increase.

**Goldman Sachs:** We expect the Bank of Korea (BOK) to keep its policy rate unchanged at 3.25% in the first MPC meeting for 2023, compared with BBG consensus of a continued 25bp hike at time of writing. Recent speeches and publications of the BOK, in particular the Governor's New Year speech and the Monetary Policy Report in late December, suggest that the MPC will likely tighten further but moderate the pace of tightening, against the backdrop of a still highly uncertain global macro and policy backdrop, including China reopening, Fed policy stance, and the Russia-Ukraine war. In the upcoming MPC meeting of January 13, we expect the BOK to pause at 3.25%, given moderating inflation pressure, weakening economic activity, and risks of another bout of money market

instability (as reflected in the still elevated spreads between the policy and CD rates notwithstanding their narrowing since mid-November). At the same time, the BOK is likely to signal its intention to keep the tightening stance until inflation is firmly on track towards its inflation target, rather than hinting a policy pivot, in order to keep policy flexibility in the face of high uncertainties for Fed policy and upcoming lifting of property market restrictions that might renew housing market speculation. In this close call, should the MPC choose to raise the rate in the January meeting, we expect the BOK to pause in the February meeting, resuming another and final 25bp hike to 3.75% in Q2.

**ING:** The market expects a 25bp hike, but we maintain our minority view that the BoK will likely stand pat this time. Since the last meeting, both inflation and inflation expectations decelerated quite meaningfully while the Korean won stabilised under the 1300 level despite a widening yield gap between the US and Korea. The BoK is expected to use the rate hike card more carefully as there is little room left to raise interest rates in this cycle given sluggish exports and economic activity. However, given the recent rise in gasoline and power prices, upside risks remain high and thus the BoK should retain a hawkish tilt despite the pause.

**Morgan Stanley:** We expect BoK to hike another 25bps in this week's meeting to bring the policy rate up to 3.50%. We think BoK will bring another 25bp hike this week in order to ensure still-high inflation (in the near term) continues to decelerate towards target and also to prevent inflation expectations, which have shown signs of stabilizing recently, from rising again. Headline inflation took a step down and has dipped by 130bps from its peak, due to base effects for food inflation and falling oil prices. The recent changes in domestic energy price policies (electricity price hike and reduction in gasoline tax cut) would slow the near-term pace of deceleration in headline inflation. But core inflation should show clearer signs of disinflation as the economy slows. On the growth front exports have continued to decelerate in December while recent data suggest domestic consumption would also soften further amidst weaker sentiment. Employment momentum is softening in turn, which would put a cap on wage growth and limit the upward pressures and the persistence of inflation. On top of the expected disinflation and slower growth, we think financial stability concerns amidst falling housing prices would also increasingly weigh on BoK going forward. Overall, we think the BoK is nearing the end of its tightening cycle. In this context, we would be watching the statement and press conference for guidance on the terminal policy rate, which had been earlier pegged at 3.50% as of the November meeting.

**Nomura:** We expect the Bank of Korea (BOK) to raise the policy rate by 25bp to 3.50% from 3.25%, as inflation remains well above its 2% target. However, we expect a dovish hike, with one or two dissenters voting for no rate hike, as there are growing concerns over the consequences of overtightening amid rising funding stress. Indeed, despite the policy support measures, money market conditions remain tight, with the spread between the 91-day CP and CD rate widening, which indicates much tighter funding conditions than the policy rate suggests. Moreover, falling house prices continue to threaten financial stability and consumption, which will likely propel the BOK to strike a balance between its first and second mandate (price stability and financial stability). As a result, we expect BOK governor Rhee to hint at a likely rate hike pause after the January hike by stating that the BOK should take time in H1 to gauge the effects of its monetary tightening on growth and financial stability. Finally, we expect no change to the distribution of the terminal rate forecasts of MPC (Monetary Policy Committee) members (three members: 3.5%; two: 3.75%; one: 3.25%).

**Societe Generale:** The BoK is expected to hike rates by 25bp to 3.50% at its policy meeting on 13 January, which is likely to mark the end of its rate-hike cycle. We have reduced our terminal policy rate forecast from 3.75% to 3.50%. The data continue to indicate weak economic activity and peaking inflation. The concerns surrounding financial stability have persisted due to high corporate leverage and housing market weakness, which would be bearish for growth outlook. Meanwhile, a further decline in the USD/KRW exchange rate reduces the pressure on the BoK to follow the Fed's tightening cycle. We conclude that the BoK will follow the 'majority view' of the Policy Board members presented in November by setting its terminal rate at 3.50%

**Scotia:** Another 25bps base rate hike is expected from the Bank of Korea on Thursday. Local analysts interpreted comments by Governor Rhee Chang-yong on November 24th after the previous hike decision to intimate that the terminal rate could be 3.5% which could make this the last of the hikes after a steep climb that began in 2021 (chart 9). A complicating factor may be that since those comments were delivered, core inflation continued to climb to 4.8% y/y which is the highest since February 2009. The Fed also delivered a more hawkish message at its

December meeting and Governor Rhee recently emphasized the importance of working with government toward a soft landing while remaining focused upon inflation.

**TD Securities:** We think the BoK is nearing its terminal rate as growth concerns take hold, with exports contracting for the trade-reliant nation. While Dec's headline inflation still remains above the BoK 2% target at 5% y/y, inflation has cooled rapidly from the highs in Jul'22. The BoK may opt to stick with an elevated policy rate of 3.5% for longer rather than continuing to hike rates.

**UoB:** High cost of utilities, food and transport continued to drive the inflation in the country. The electricity prices are set for a 9.5% jump in 1Q23 which may lift the inflation this month. ▪ The current elevated inflation environment would warrant another 25bps rate hike to bring the 7-day repo rate to 3.50% at the upcoming monetary policy meeting on 13 Jan. We see that as the "terminal rate" as slowing economic growth will increasingly dominate the policy setting.


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