



Economics Group

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Amid Many Uncertainties, Bank of Korea Stays on Hold

The Bank of Korea held its key lending rate unchanged at 1.50 percent at its May meeting. The official statement and comments tilt slightly dovish suggesting no hurry on the part of policymakers to raise rates soon.

BoK Not Feeling Pressure to Keep Pace with other Central Banks

As widely expected, the Bank of Korea (BoK) left its base rate unchanged at 1.5 percent at its May meeting. After having raised its key lending rate for the first time in six years in November 2017, financial markets have been looking for clues as to when the BoK will make progress toward further monetary policy tightening.

The BoK cited worries about the effects of a broad normalization in policy rates of other major economies, jitters in emerging markets, and worries about uncertain trade policies in other economies as reasons to stand pat.

Many of these concerns are about things going on outside of Korea; the domestic economy is actually doing pretty well. GDP growth increased 1.1 percent in the first quarter (not annualized) after a modest 0.2 percent decline in the fourth quarter of 2017.

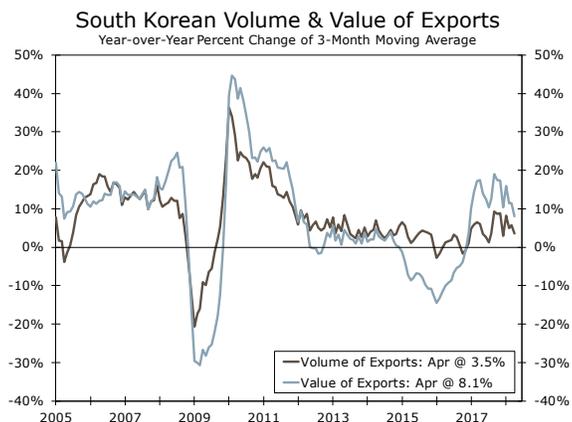
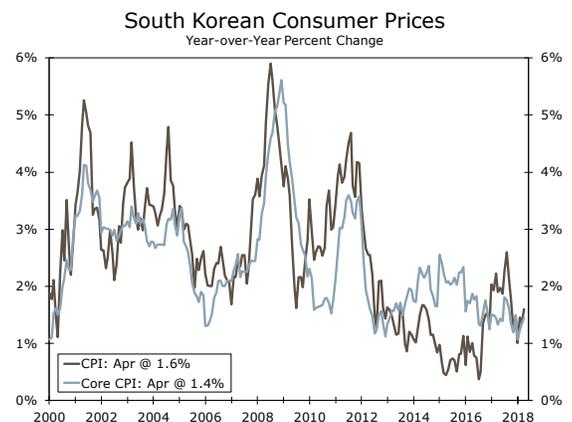
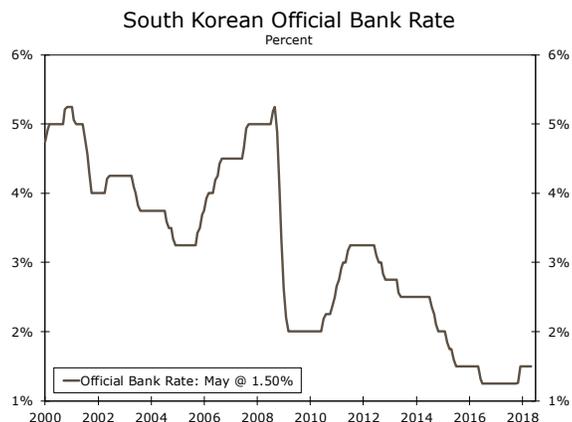
Inflationary pressures remain broadly benign, suggesting any policy tightening this year would likely be modest. CPI inflation picked up slightly in April to lift the year-over-year rate to 1.6 percent from 1.3 percent previously, but that is still below the BoK's 2 percent inflation target, likely causing caution of raising borrowing costs.

Real exports of goods and services, which were particularly strong in the first quarter, are equivalent to about 55 percent of GDP. Although Korea was permanently exempt from the 25 percent tariffs on steel implemented by the United States, it is still subject to export quotas that limit steel exports to 70 percent of the average from 2015-2017. Uncertainties pertaining to future global trade dynamics remain and are a great source of uncertainty for the BoK. Uncertainties about U.S. trade policy in particular was highlighted in the official statement.

China is South Korea's largest export market, comprising roughly one-quarter of South Korea's total exports. On that basis, trade disputes between the United States and China are important to Korea, as a decrease in Chinese exports to the United States would have large implications for South Korea's export market, and for the overall economy.

The unemployment rate hit an eight-year high in March 2017, but has since modestly subsided. Personal consumption was weak in the first quarter; however, business fixed investment was relatively strong, perhaps reflecting confidence among businesses on the coming outlook of the consumer.

We are not yet convinced that growth in South Korea is so robust as to compel the BoK to imminent action, at least not until inflation approaches its 2 percent target rate. Structural headwinds like slower labor force growth will be a headwind to economic growth over time. But with GDP growth gradually picking up and a broad normalization in interest rates globally, the BoK has scope to raise rates again should inflation rise to the target rate.



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