Economics

# DBS Flash

# South Korea: Quite possibly the last rate cut this year

**Economics/South Korea/Monetary**

Group Research

October 16, 2019


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- *The Bank of Korea has delivered its second and possibly last rate cut this year. The 7D repo rate was lowered by 25 bps to its record low of 1.25% at today's meeting*
- *Macroeconomic factors – growth worries and deflation concerns – were the main reasons behind the ease*
- *The room for another cut remains but it can come next year because domestic demand has stabilised, property prices have rebounded and inflation may have bottomed*
- ***Implication for forecasts:** The 7D repo rate will remain at 1.25% for the rest of 2019. A 25bps rate cut in 1H20 cannot be ruled out*
- ***Implication for investors:** The impact on the bond and FX markets should be small as today's policy move was widely expected*

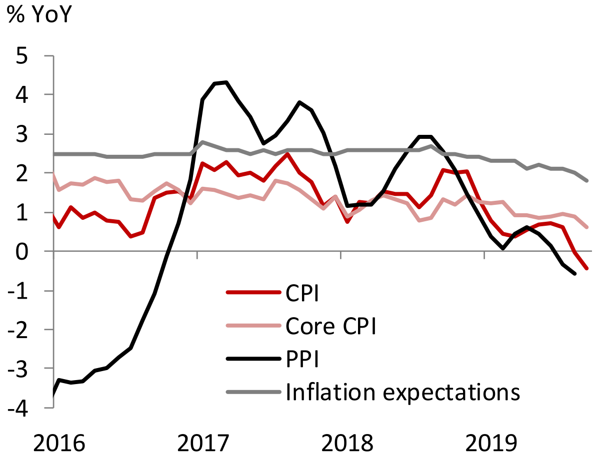
In line with our expectations, the Bank of Korea cut rates for a second time this year at today's meeting. The 25bps rate cut effectively returned the benchmark 7D repo rate to its record low 1.25% level for the first time since October 2017.

## Growth worries and deflation concerns

Growth worries and deflation concerns were the main reasons behind today's policy move. Exports contracted for a tenth straight month by a sharp -11.7% YoY in September. The adverse impact of global growth slowdown and trade protectionism (Japan's removal of South Korea from its whitelist in August, the additional US tariff hikes on Chinese products in September) has become more notable.

For the first time in more than half a century, CPI inflation turned negative at -0.4% YoY in September. Core CPI also slipped to 0.6%, its lowest since 2000. Sluggish commodity prices, a negative output gap, and slack labour market all contributed to the recent decline in inflation.

**South Korea: Inflation and inflation expectations**



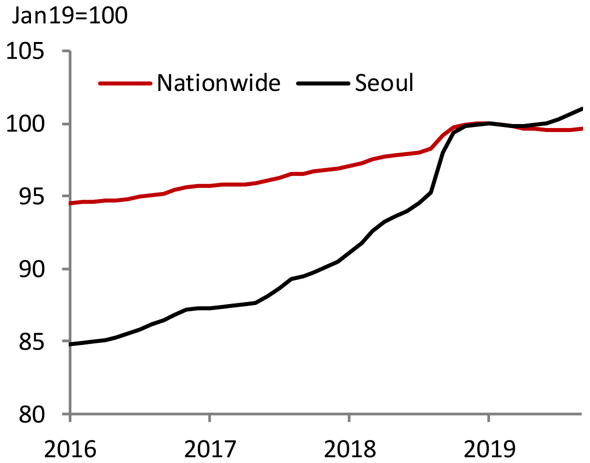

Sources: CEIC, DBS

## Rate cuts are done for this year

Rate cuts are done for this year, in our view. The BOK indicated in today's policy statement that it will observe the effects of the two rate cuts delivered so far this year. Hence, the BOK sees no urgency to further ease monetary policy in the near term.

Indeed, domestic demand has shown some encouraging signs of stabilisation, probably helped by the latest fiscal and monetary stimulus measures. Retail sales rose notably by 3.9% MoM sa in August while consumer confidence edged upward by 4.4ppt in September. Property prices have started to pick up again in the wake of the first rate cut in July. On the MoM basis, the pace of house price increases has picked up to 0.3-0.4% in July-September vs nearly 0% in 1H19.

South Korea: Housing prices




Sources: CEIC. DBS

Inflation may have bottomed. The high base effect for CPI from weather shocks and a surge in food prices last year will dissipate from December. There is a good chance that CPI figures will return to the positive territory from November/December.

## Further easing remains possible in 2020

Looking ahead, the BOK could ease again in 2020. During today's press conference, Governor Lee saw room for the BOK to take further policy actions, if needed. The BOK could study non-rate policy tools if the room for rate cuts shrinks, while ruling out the option of QE.

Indeed, the benchmark rate has not reached the zero bound or Taylor rule implied policy rate of 1% (based on our estimate). A prolonged period of low interest rates could be tolerated by the central bank, given that the natural rate is also declining as a result of the structural slowdown in GDP growth and downshift in inflation and inflation expectations.

We forecast for the 7D repo rate to stay unchanged at 1.25% for the rest of 2019. Looking into 2020, we do not rule out another 25bps cut in 1H.

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**Sources**: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).