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Economics Group

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Bank of Korea Keeps Rates on Hold and an Eye on the U.S.

The Bank of Korea kept its Base Rate unchanged at 1.25 percent, while noting a firming in the outlook for the domestic economy and the up- and down-side risks of U.S. fiscal and monetary policy on the global economy.

Global Expansion and Firming Domestic Economy

Earlier today, the Bank of Korea's (BoK) Monetary Policy Board opted to leave the target interest rate unchanged at 1.25 percent. Given the importance of trade to the South Korean economy, it is not uncommon for the statement accompanying the monetary policy decision to focus on international developments. Still, it is notable how prominently U.S. fiscal and monetary policy factor into the BoK's assessment of the global economy and its impact on Korea. The BoK sees the global recovery as being affected by "the directions of the US government's economic policies, the pace of monetary policy normalization by the U.S. Federal Reserve, the movements toward spreading trade protectionism, and political uncertainties in major countries."

On the domestic front, the BoK cited improving employment trends and a firming in exports as key factors in its judgment that the South Korean economy is growing slightly faster than its projected path in April.

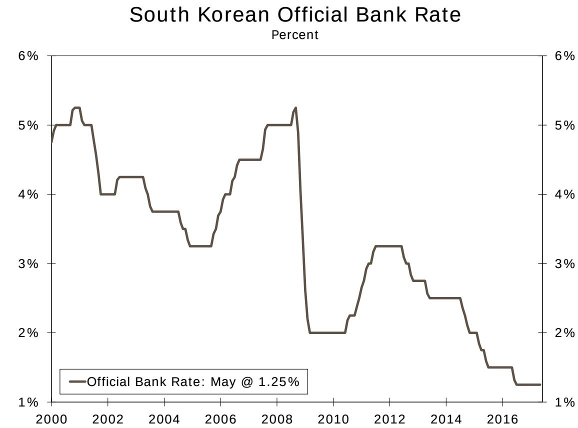
Inflation and Consumer Debt and Spending Dynamics

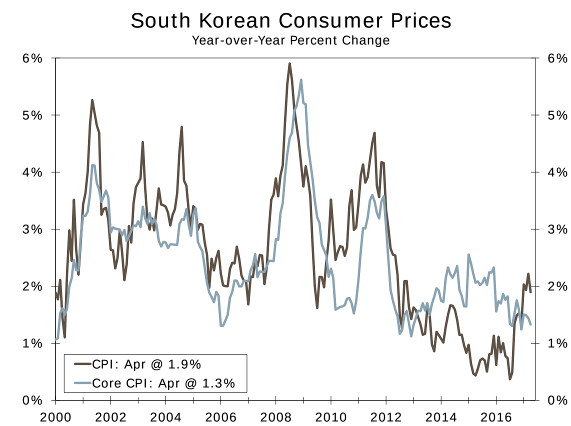
In the first four months of 2017, CPI inflation in South Korea has been within two-tenths of a percentage point of the BoK's 2.0 percent target. Stripping away food and energy prices, core CPI has been running about half a percentage point slower. Today's statement noted the role of rising prices in petroleum and agriculture as well as livestock and fishery products in lifting headline inflation, while acknowledging that core inflation would remain in the "mid- to upper- 1% range."

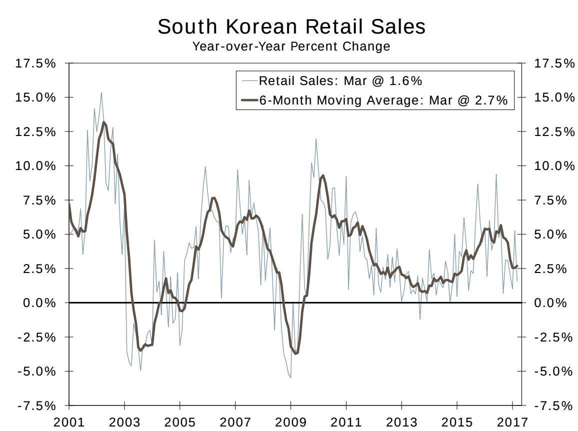
We are growing increasingly concerned about elevated levels of consumer debt in South Korea. According to BoK's own data, household debt has doubled since 2008. The growth in consumer debt is outpacing growth in the broader economy. Over the same 2008-2016 time period, nominal GDP there has only increased 26.7 percent. The BoK tacitly recognized this dynamic without expressing too much caution observing that the rate of household lending growth is showing signs of lessening. Governor Lee expressed a somewhat greater degree of concern in the press conference that followed the meeting.

One key challenge for the BoK in coming quarters will be riding the line of balance between keeping rates low enough to stimulate growth without keeping rates so low that it engenders even more consumer leveraging. If South Korea's households, which tend to be older-aged, take on too much debt with low interest rates, it could hold back future consumer spending, particularly if rates eventually rise.

Newly elected South Korean President Moon Jae-in is well aware of the growing indebtedness of the household sector and has pledged to lift government spending.







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