

South Korea: Toning Down Hawkish Stance But Not Easing Monetary Policy Yet

The Bank of Korea (BoK) kept its benchmark base rate steady at 3.25% today for the fifth consecutive meeting in line with market's expectation. While it continued to warn against high inflation which will "fluctuate at a high level for the time being", the bias of the monetary policy decision has turned more neutral. The BoK dropped its reference to "greater emphasis" on price stability for the conduct of the monetary policy. On the growth prospects, BoK said "the domestic economy will keep up its long-term trend of growth going forward" but highlighted the huge downside risks to growth as a result of the external risks. The comments pointed clearly to a more neutral bias in the near-term, unless external economic conditions dropped sharply. Governor Kim Choong-soo continued to manage expectation of a rate cut in the near-term as he reiterated that monetary policy easing was not discussed at today's meeting.

High domestic inflation keeping real interest rates in the negative territory continued to hold back any monetary policy easing intention. Headline inflation has eased to 3.9% y/y in Oct from as high as 5.3% in Aug. We expect inflation to head back above 4.0% in the next two months before settling into the BoK's 2%-4% target in 2012. Core inflation has also remained elevated at 3.7% y/y in Oct. With easing inflation, the BoK will be more prepared for rate cuts in the first half of 2012.

FX Implication

The monetary policy decision was no surprise to the market and the comments support views that the BoK will maintain steady interest rates in the next two months. USD/KRW has pulled back below 1,130 from a close of 1,134.20 on Thur as market calmed following the risk aversion trade yesterday. Our year-end target for USD/KRW is still at 1,170, reflecting the risks until then.