

## South Korea: BoK Surprised With No Move

The BoK surprised market by holding its benchmark base rate steady at 3.00% today. The decision came on the back of recent pullback in oil prices and fresh concerns in the Eurozone. The monetary policy decision was also constrained by high household debt and the softening domestic real estate market. The sluggish outlook for the property market has also triggered liquidity issues at the local savings banks which are heavily exposed to the construction industry.

BoK governor Kim Choong-soo said that the decision today was not unanimous, suggesting that there would continue to be pressure to raise rates in June with the domestic headline inflation expected to remain high at above 4% y/y until August. The BoK's inflation target is 2%-4%. The BoK said that price pressure will remain strong as a result of strengthening domestic demand and high oil prices.

Given that economic growth is on track and price stability remains the key focus, we believe the BoK is still on track to hike by another 50 bps to bring the base rate to 3.50% by end-3Q11. We expect the next rate hike to materialize by July while market is now leaning towards a rate hike in June. In total, the BoK has already raised interest rate by 100 bps, of which 50 bps was delivered in 1Q11. Korea Treasury bond yields initially dropped following the rate announcement but have since recovered most of the losses. The 5-year yield fell to 3.92% before moving back up to end flat at 4.03%.

On the FX front, there is clearly more willingness to allow for faster pace of KRW appreciation. The BoK highlighted today that the policy mix of interest rates and currency strengthening are required to contain the inflationary pressure. KRW has strengthened by around 4.4% against USD YTD. We expect KRW to head higher to 1,050/USD by 3Q11 after recording a closing high of 1,065/USD earlier this month.