

## Bank of Korea Injects Further Monetary Stimulus

- The Bank of Korea lowered its benchmark interest rate to 1.25%, adding to the monetary stimulus implemented in July.
- The central bank will take its time to assess the impact of the rate cuts, but notes that there is room left for further easing if needed.

The Bank of Korea (BoK) lowered the Base Rate by 25 basis points to 1.25% following the October 16 monetary policy meeting (chart 1). The benchmark rate had also been cut by the same magnitude in July. The decision to lower the policy rate was not unanimous, as two members in the seven-member Monetary Policy Board voted for the rate to be kept on hold. We—along with the majority of analysts surveyed by Bloomberg—had anticipated the cut on the back of recent economic weakness and the BoK's signals that it was studying the need for further policy adjustment.

The BoK is increasingly concerned about the economy's outlook. While policymakers noted that growth in South Korean domestic demand was weakening, they emphasized that persistent external sector uncertainties, particularly the US-China trade dispute, were a key culprit for the economy's softness. Indeed, we point out that the export-oriented economy is simultaneously weighed down by: 1) softening global demand dynamics; 2) trade tensions between the US and China and associated supply-chain ripple effects; 3) the ongoing downturn in the global electronics sector, which reflects lower Chinese demand and smartphones' longer replacement cycle; and 4) the Japan-South Korea dispute and subsequent export restrictions set by Japan on materials critical to the South Korean semiconductor sector. The external sector outlook is potentially further jeopardized by the expected decision by the US administration by mid-November on whether it will move ahead with tariffs on automobile imports. Accordingly, the South Korean economy will likely grow by slightly over 2% y/y in 2019, below the economy's potential growth of around 2½%.

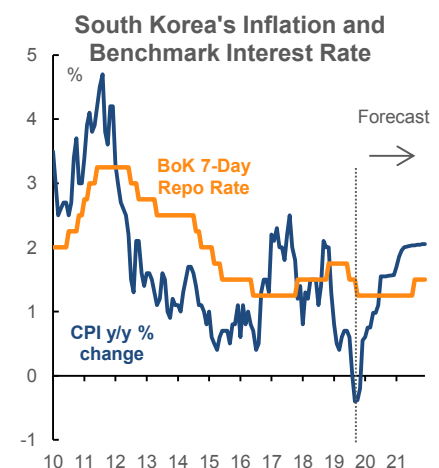
Against the backdrop of economic weakness, inflationary pressures remain absent in South Korea (the CPI dropped by 0.4% y/y in September), allowing for looser monetary conditions. With demand-driven price pressures likely to stay low in the foreseeable future, the BoK expects headline inflation to remain near 0% in the near-term and climb up to about 1% y/y in 2020, remaining significantly below the central bank's 2% y/y inflation target.

The BoK maintained its accommodative monetary policy stance and left the door open for further stimulus. Despite the fact that the benchmark repo rate has reached the lowest level on record, BoK Governor Lee Ju-yeol noted that the central bank has room for further policy action if needed. Nevertheless, the BoK will likely adopt a wait-and-see approach in the near-term, as it assesses the impact of the two rate cuts. Moreover, developments on the trade front will play a key role in future policy decisions. While our BoK forecast does not include any additional rate cuts at this point, we highlight that the economy faces notable downside risks, which may trigger further action by the BoK. Moreover, we expect that fiscal policy will become more growth-supportive over the coming months, complementing the central bank's monetary stimulus efforts.

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Chart 1



Sources: Scotiabank Economics, Bloomberg.

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