FIXED INCOME ISSUE REPORT

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July MPC Meeting Preview

Unanimous 25bp hike expected; market already eyeing next step

- We expect the Bank of Korea's Monetary Policy Committee to vote unanimously to raise its policy rate by 25bps to 2.75% in July.
- While markets are focused on signals regarding the terminal rate, we do not anticipate updates to economic projections or the dot plot at this meeting.
- Given the governor's usual communication style, we expect forward guidance to remain extremely limited.

July Monetary Policy Committee meeting: Unanimous 25bp hike likely

Ahead of the Jul 16 Monetary Policy Committee (MPC) meeting, we expect the Bank of Korea (BOK) to raise its policy rate by 25bps from 2.50% to 2.75%. The May meeting provided clear signals of an impending hike: two dissenting members supported an increase, the growth and inflation forecasts were raised substantially—to 2.6% and 2.7%, respectively, and 19 of the 21 committee members projected rates above the current level. The July meeting should mark the transition from signaling to action, with a unanimous hike now the most likely outcome, in our view. Governor Shin Hyun-song reaffirmed the case for a rate increase during his Jul 9 briefing to the National Assembly's Strategy and Finance Committee, stating: "Given persistent inflation above target, improving growth momentum, and rising financial stability risks, it is necessary to raise the base rate at an appropriate time." He also cited stronger growth driven by strong semiconductor exports and improved terms of trade, as well as renewed housing-price increases in the Seoul metropolitan area, citing these as evidence of mounting financial imbalances that strengthen the case for tightening.

Headline inflation may have peaked, but BOK's assessment still critical

June CPI inflation reached 3.2%, its highest level in two and a half years. Upon closer inspection, however, the increase was driven largely by supply-side factors, particularly oil products and agricultural/fishery products, while core inflation eased to 2.4% from 2.5% in May. Given that oil prices have fallen from over USD110/bbl to the low USD70s following ceasefire talks between the US and Iran, headline inflation may already have peaked. The key issue now is the BOK's evaluation of core inflation and demand-side pressures. The extent to which the MPC emphasizes demand-driven inflation at its post-meeting press conference should determine whether market expectations for a consecutive hike in August remain elevated. Our baseline scenario is for two 25bp hikes this year—in July and October—taking the policy rate to 3.0% by year-end. We then project two further hikes in 1H27, to reach a terminal rate of 3.5%.

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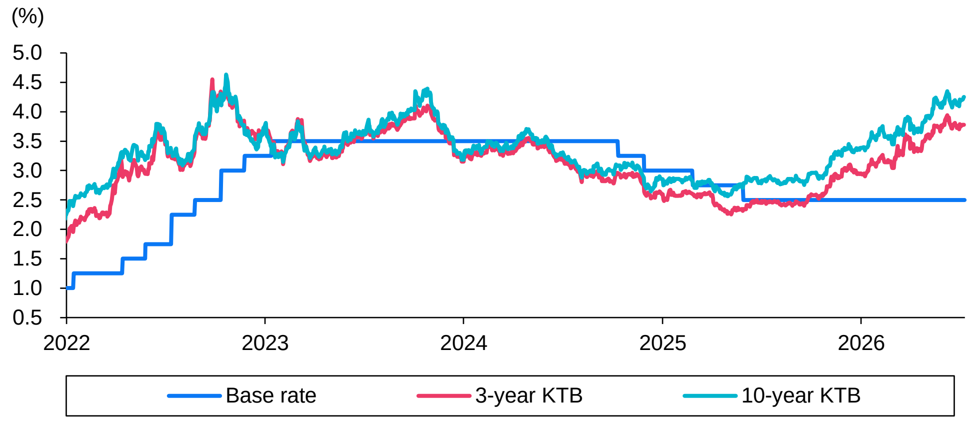
Bond market more sensitive to pace of tightening than to the hikes themselves

The fixed-income market has largely priced in the projected July hike. Yields on 3-year KTBs stand at 3.78%, nearly 130bps above the policy rate, while forward rates imply more than four hikes over the next 12 months. (As of early June, markets had priced in as many as six hikes; current STRIPS-implied forward rates remain at broadly similar levels.)

Market pricing already exceeds our 3.5% terminal-rate forecast, which is equivalent to four 25bp hikes. Accordingly, a rate hike itself is unlikely to push yields materially higher from current levels. Rather, if the MPC's post-meeting statement or press conference is less hawkish than expected—particularly in light of the sharp decline in oil prices and stabilizing core inflation—the resulting reduction in uncertainty could trigger downward pressure on yields.

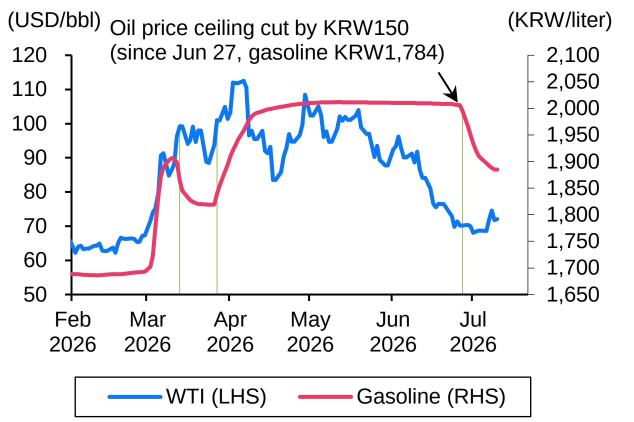
Weakness in ultra-long-dated bonds may persist regardless of the policy decision. The 10-/30-year KTB spread began to normalize on Jun 5 and now stands at +20bps. Insurers' capacity to purchase bonds has diminished, while higher K-ICS ratios have reduced their incentive to hold ultra-long-duration bonds. The extent of any further widening in the ultra-long segment should depend largely on the Ministry of Finance and Economy's issuance strategy for long-term bonds.

Korea's base rate vs yields on 3- and 10-year KTBs



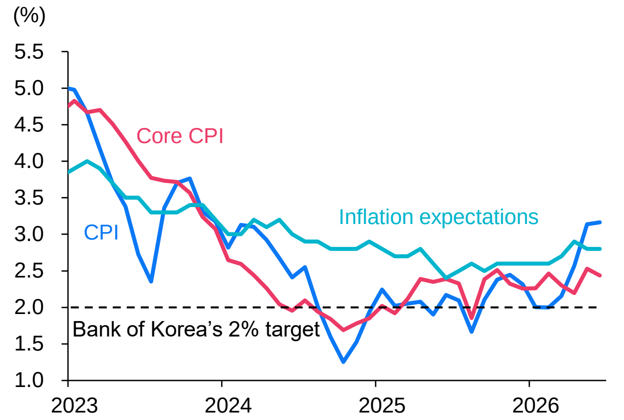
Source: KOFIA, Samsung Securities

WTI oil prices vs retail gasoline prices



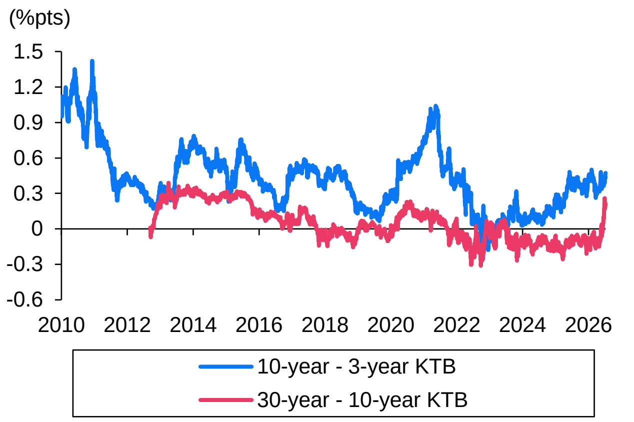
Source: Bloomberg, Korea National Oil Corporation, Samsung Securities

CPI inflation vs inflation expectations



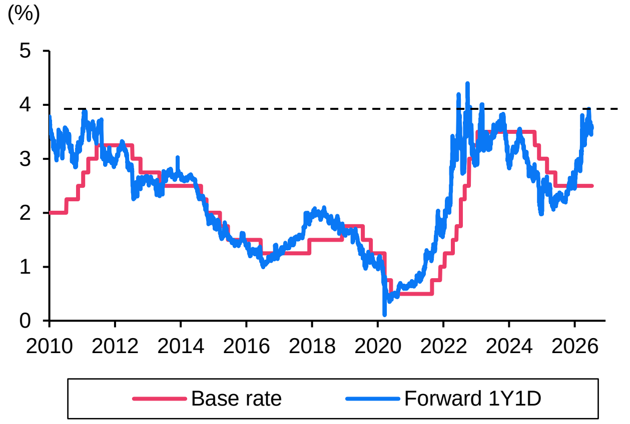
Source: Ministry of Data and Statistics, Samsung Securities

Ultra-long segment spread widens recently



Source: KOFIA, Samsung Securities

Base rate vs forward rate



Source: Bloomberg, Samsung Securities

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