FIXED INCOME ISSUE REPORT

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July MPC Review

BOK unanimously hikes base rate, as expected

- At its Jul 16 Monetary Policy Committee meeting, the Bank of Korea delivered the widely expected 25bp hike, unanimously raising the base rate from 2.50% to 2.75%—its first increase in three and a half years. The governor remained cautious in his assessment of when the GDP gap might turn positive, suggesting that a consecutive rate hike in August is unlikely.
- We expect another 25bp hike in October, followed by two additional increases in 1H27, taking the policy rate to 3.5%.
- The bond market has largely priced in our projected rate path, but several key variables must be confirmed before yields can stabilize.

Unanimous rate hike in line with expectations

At its Jul 16 Monetary Policy Committee (MPC) meeting, the Bank of Korea (BOK) unanimously raised its base rate by 25bps from 2.50% to 2.75%—its first hike in three and a half years—in line with both our forecast and market expectations. The interest rate on Financial Intermediary Support Loans was also raised to 1.25%.

In its post-meeting statement, the BOK attributed the hike to "strengthening growth momentum, driven by exports and investment, alongside inflation rates that are expected to remain above the target level for a considerable period, with persistent risks to financial stability." The central bank also said it now expects this year's GDP growth to significantly exceed its May forecast of 2.6%. It maintained its consumer price inflation forecast broadly in line with the May projection of 2.7% but expected core inflation to slightly exceed its prior forecast of 2.4%. (Core inflation stood at 2.5% y-y in June.)

Governor's post-meeting comments not uniformly hawkish

Hawkish elements of the governor's remarks included: 1) his reference to the US Fed's 2021 mistake of treating demand-driven inflation as transitory, underscoring the MPC's consensus that demand-side pressures not be overlooked; and 2) his statement that all options remain open for the August meeting, describing upcoming policy meetings as "live meetings" whose outcomes are truly uncertain.

However, several dovish elements were also evident: 1) his acknowledgment of recent weakness in the domestic labor market and assertion that fiscal and financial policies should help ease the burden on low-credit borrowers; 2) his caution regarding the sustainability and economic implications of the unusually wide GDP-GDI divergence (1Q GDI: up 13.2% y-y vs GDP: up 3.8% y-y); and 3) his lack of conviction over the timing of the GDP gap turning positive, despite noting that this could occur before early next year. Bond yields continued to decline through the end of the press conference, indicating that the market viewed the outcome as less hawkish than expected.

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Outlook: Next rate hike expected in October (year-end rate at 3%; terminal rate at 3.50%)

We maintain our base-rate trajectory. Our forecast calls for two 25bp hikes this year—July's increase and another in October—taking the policy rate to 3% by year-end. We then expect two further hikes in 1H27 to reach a terminal rate of 3.5%.

We see little likelihood of a consecutive hike at the Aug 27 meeting. Although the BOK governor clearly signaled the direction of policy, he remained cautious regarding key economic indicators, particularly employment trends, the sustainability of the GDP-GDI divergence, and broader growth dynamics. His remarks conveyed no urgency to accelerate the pace of tightening.

The May dot plot indicated a consensus for two hikes within six months. Given the impact of the July decision and several pending data points—including 2Q GDP and GDI on Jul 23, and inflation data through July and August—we believe the next move will be carefully calibrated. We therefore view the Oct 22 MPC meeting as the most likely timing for the next hike.

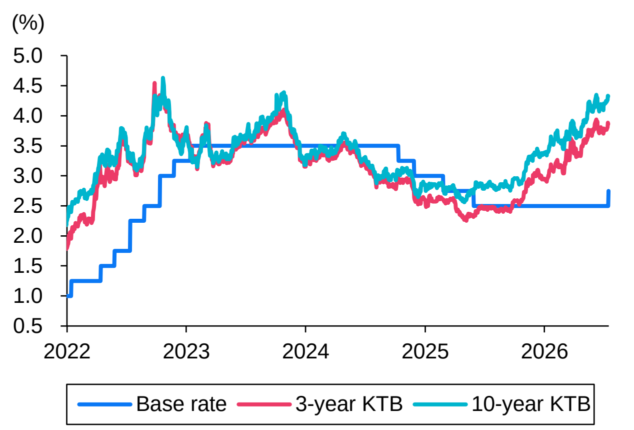
Bond market: Expected hikes largely priced in; yield stabilization will take time

The bond market has already priced in much of our projected rate path, as reflected in its relatively positive response to the less-hawkish-than-expected outcome. Recent yield increases have largely reflected upward revisions to growth and inflation expectations.

For yields to stabilize—or decline meaningfully—several key variables still require confirmation: 1) 2Q GDP on Jul 23, which should help determine whether the 1Q upside surprise was a one-off or signals a sustained upward revision to full-year growth; 2) the government's budget plan in late August, which should clarify next year's treasury issuance schedule and supply-demand dynamics; and 3) progress toward US-Iran de-escalation, as well as trends in oil prices and exchange rates.

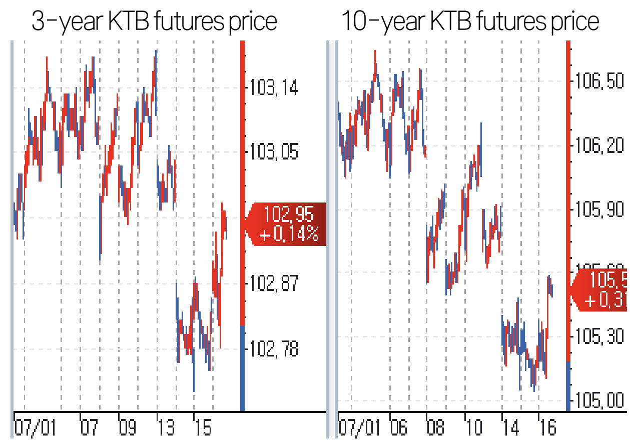
With the budget announcement still pending, market sentiment remains cautious, and there is no clear catalyst for a sustained rally. We expect yields to remain range-bound in the near term, fluctuating around current levels.

Korea's base rate vs major KTB yields



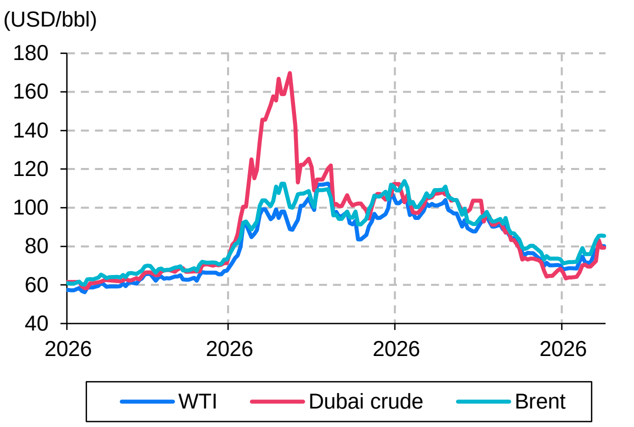
Source: KOFIA, Samsung Securities

KTB futures on MPC meeting day: Gains widen during post-meeting press conference



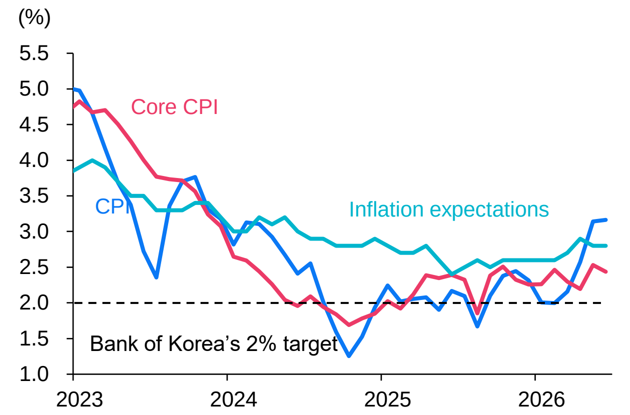
Source: Infomax, Samsung Securities

Oil prices: Rising again in July



Source: Bloomberg, Samsung Securities

CPI inflation and inflation expectations



Source: Ministry of Data and Statistics, Samsung Securities

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