MACRO MORNING BRIEFING

iFlow

January 9, 2025

BoK Seeks Greater Growth through Further Easing

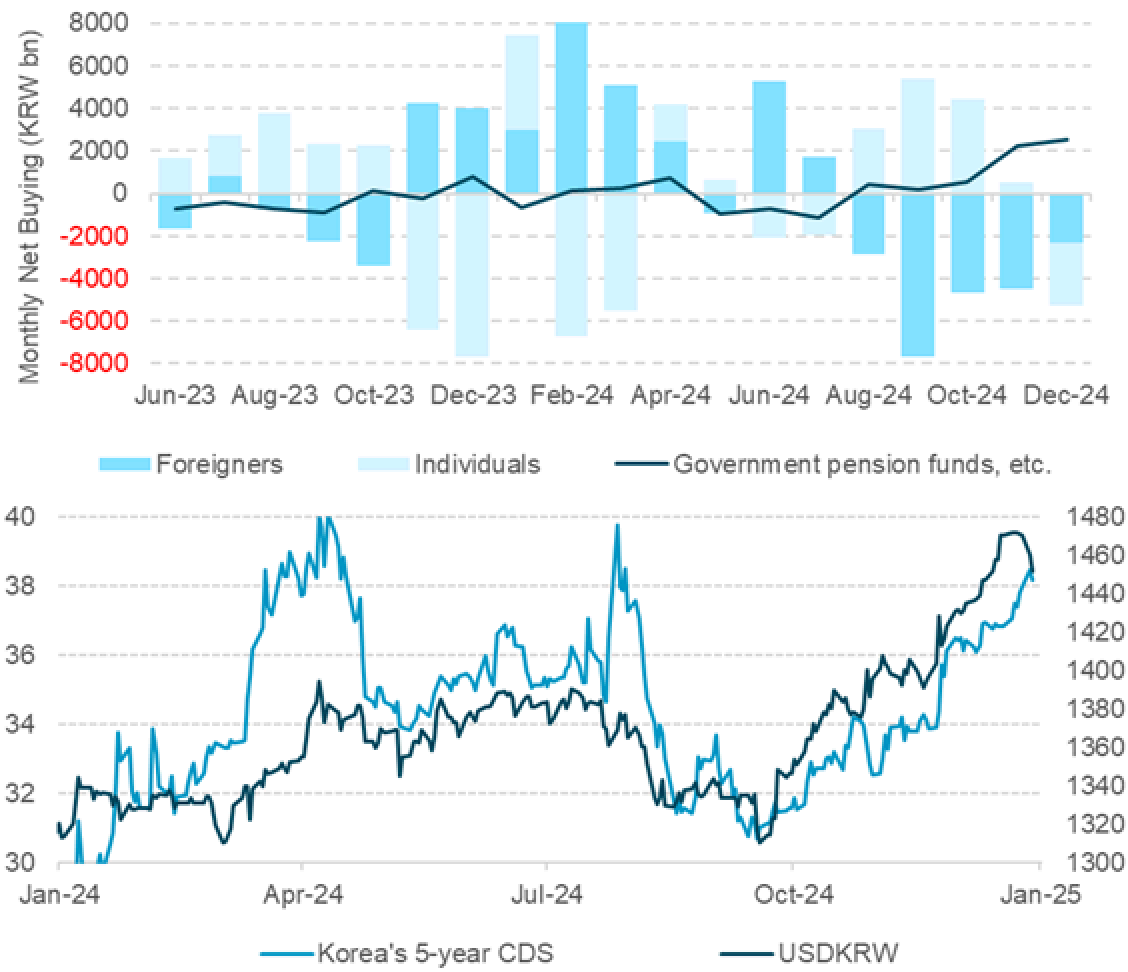
- Domestic equities are supported by pension fund demand
- Aggressive monetary easing will likely mitigate downside growth risk, but weigh on the won
- Increasing hedging demand to keep APAC FX in underheld condition

Despite the ongoing political turmoil in South Korea foreign investor sentiment has remained resilient. The KOSPI selloff in December 2024 was relatively contained with limited foreign capital outflows. Official data provided by the Korea Exchange showed KRW 2,968bn in net foreign selling, less than half the average volume of KRW 5,606bn for the three previous months from September to November 2024. The selling pressure in December came mostly from domestic investors, with net sales reaching their highest level since March 2024 (when sales reached KRW 5,522bn) on purchases by government pension funds and financial investment firms. Government pension funds accounted for net purchases of KRW 2,506bn, the most since March 2020 amid Covid-19 fears. This trend is interesting in the context of the broad allocation shift from a domestic to a global equity strategy over the past four years (Exhibit #1). We will continue to monitor the direction of flows by government pension funds to determine whether this represents a trend reversal or is merely a temporary strategy in an attempt to stabilize the domestic equities market.

Overall flow sentiment in 2025 has been encouraging, with net buying by foreign investors and government pension funds and individual investors biased toward selling. Korean assets appreciated as the KOSPI rose and the Korean won strengthened, against broad weakness in the APAC region. We believe the next leg of the rally will come from the unwinding of the political premium. South Korea's five-year credit default swap (CDS) rate, a measure of sovereign credit risk, surged in early December and has hovered around its 2024 highs. As Exhibit #1 shows, the unwinding of the political premium is likely to benefit the Korean won and thus boost market sentiment. Near-term political developments are likely to have an indirect impact on domestic asset pricing.

Looking ahead, the next South Korean presidential election, which was originally scheduled for 2027, might instead be called this year. By law, a presidential election must be held within the next 60 days if the Constitutional Court of Korea rules against impeached President Yoon.

Exhibit #1: KOSPI Flows by Investors and Korea's Credit Default Swap



Source: BNY, Bloomberg L.P., KRX Market Data System

South Korea's economic growth momentum slowed more sharply than expected in the second half of 2024. The country's business non-manufacturing confidence index plunged by 10 points in January 2025, the most since a 23-point drop in April 2020 following the outbreak of Covid-19, and both the manufacturing and non-manufacturing indexes have declined to their 2020 lows. Looking at the manufacturing sector, domestic enterprise sentiment was the main drag, while confidence among exporters remains relatively supportive, albeit lower than the high reached in 2024 (Exhibit #2).

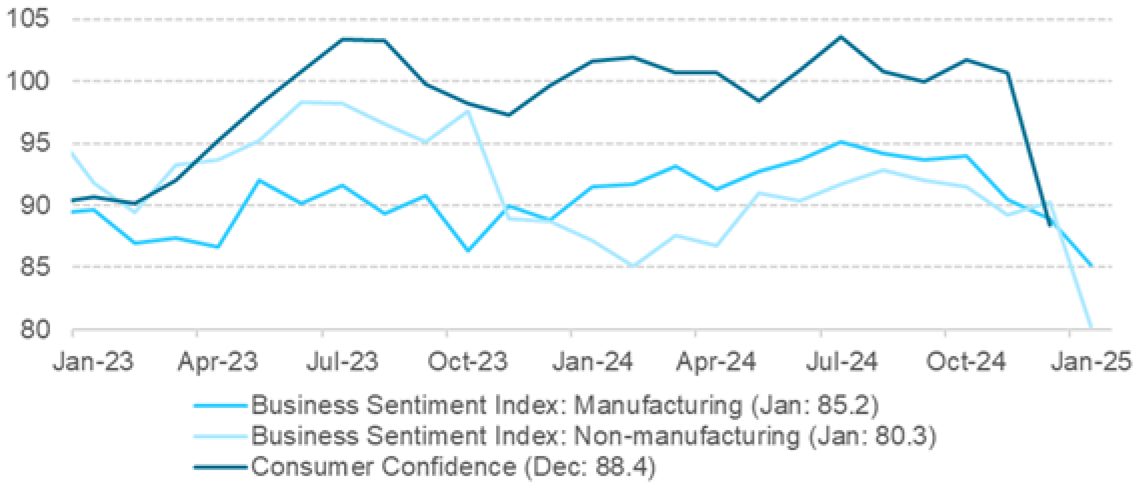
Downside growth risks have risen sharply on the back of uncertainty about the momentum of global tech-related exports and the impact of potential US tariffs. The Ministry of Finance recently revised its forecast for 2025 GDP growth down from 2.2% to 1.8% and decreased its CPI forecast from 2.1% to 1.8% y/y. This raises the prospect of the Bank of Korea (BoK) following suit (the central bank currently projects both 2025 GDP and CPI to be 1.9% y/y).

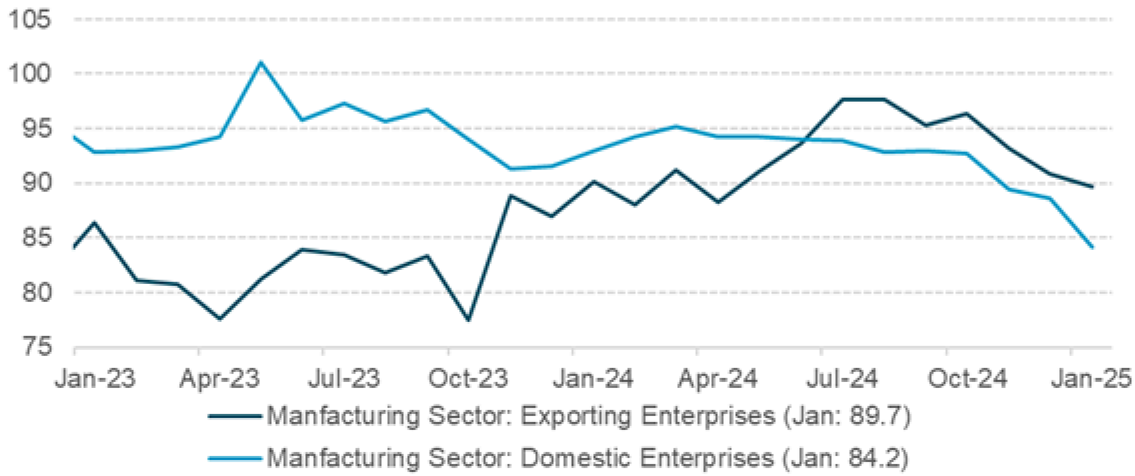
Aside from well-telegraphed and documented capital market and financial market reforms (including the corporate value-up plan, the foreign exchange liberalization plan, the inclusion of Korean government bonds in the FTSE World Government Bond Index, etc.), the recent shift by the BoK and the South Korean authorities is, in our view, important to provide much needed and timely support to the South Korean economy. For example, the swift and coordinated effort by the BoK and the financial market authorities to mitigate the fallout from the debt default by a local developer in Q4 2022 proved to be very effective.

The BoK recently made rare back-to-back rate cuts in October and November 2024, a move not seen since the 2008 global financial crisis. It did so in order to preemptively safeguard South Korea's economic growth. In its annual monetary policy outlook for 2025, the BoK explicitly said that it will "flexibly adjust the pace of base rate cuts in line with changes in economic conditions to ensure that inflation remains stable and downward pressures on growth are mitigated." In our view, this is undoubtedly a sign of the BoK's willingness to do whatever it takes to weather the current economic downturn.

Along with potentially expansive fiscal policies ahead, this should provide the necessary support to stabilize domestic sentiment but might come at the expense of the Korean won, as rate cuts and a widening deficit are likely to weigh on the currency in the near term.

Exhibit #2: Sharp Drop in Consumer and Business Confidence



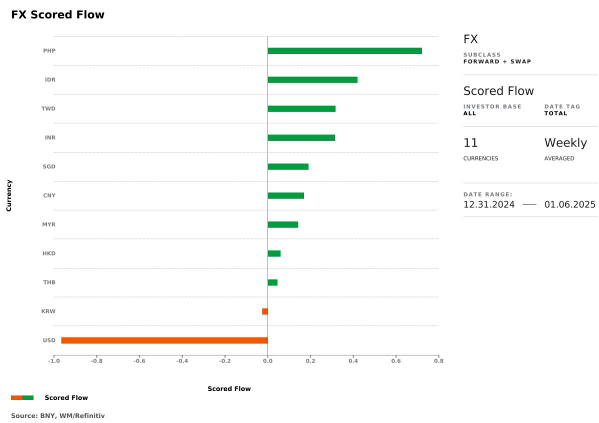


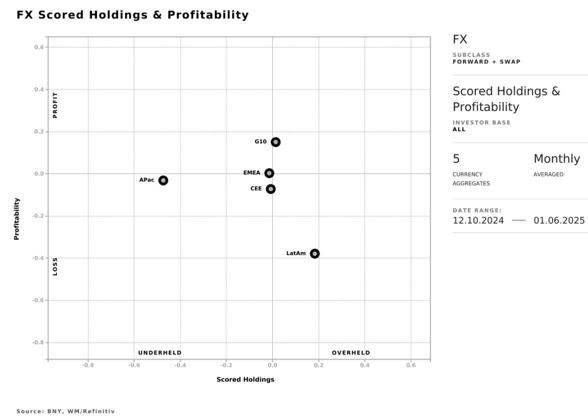
Source: BNY, Bloomberg L.P.

Over the past week, the reversal of US dollar flows has benefited flows into APAC and most other emerging market currencies. PHP, IDR and TWD were the top recipients of flows in the first trading week of the year. The Korean won was the odd currency out, posting marginal outflows, against positive momentum by the Korean won, which has rallied, climbing by over 1% year-to-date, from 1,472 at the end of 2024 to around 1,450 as of Wednesday.

On an aggregate basis, APAC is the most underheld region globally against a nearly neutral G10, EMEA and CEE and a marginally overheld LatAm. Concerns about growth in China and a slowdown in South Korea and heightened uncertainty about potential tariffs have increased hedging demand in the region. This is most apparent with the Indian rupee, as scored holdings for INR collapsed from over +4 in October 2024 to near flat in January 2025.

Exhibit #3: APAC FX Inflows on USD Outflows - APAC Currencies Underheld on Hedging Demand





Source: BNY, Bloomberg L.P.

Please direct questions or comments to: iFlow@bny.com

Disclaimer & Disclosures

Wee Khoon Chong

APAC MARKET STRATEGIST

CONTACT WEE KHOON

Can't see the email? View online

Contact Us | iflow@bny.com

This message was sent from an unmonitored email box. Please do not reply to this message.

.